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IN THE

Supreme Court of the United States

October Term, 1975
No. 75-596

HOWARD BERSCH,

Petitioner,

v.

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1975

No._____

Howard Bersch,

Petitioner,

-against-

Arthur Andersen & Co., I.O.S., Ltd., and Bernard Cornfeld,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered on April 28, 1975.

OPINIONS BELOW

The opinion of the United States District Court for the Southern District of

New York (Hon. Robert L. Carter), determining,on defendants' motions to dismiss, that the Court had subject matter jurisdiction under the Securities Act of 1933, 15 USC §§77a et seq. and the Securities Exchange Act of 1934, 14 USC §§78a et seq., that the Court had personal jurisdiction over all defendants except J. H. Crang & Co. and certifying the question of subject matter jurisdiction pursuant to 28 USC §1292, was filed on December 4, 1974 and is reported at 389 F. Supp. 446 (S.D.N.Y. 1974). The opinion is printed as Appendix "A" to this Petition.

The opinion of the United States Court of Appeals for the Second Circuit, reversing the determination of subject matter jurisdiction with respect to all class members except American citizens and residents and remanding, and affirming the judgment dismissing the complaint as against defendant

J. H. Crang & Co. on grounds of lack of personal jurisdiction, was rendered on April 28, 1975 and is reported at 519 F. 2d 974 (2d Cir. 1975). The opinion is printed as Appendix "B" to this Petition.

JURISDICTION

The judgment of the Court of Appeals was entered on April 28, 1975. A timely petition for rehearing was denied by the Court of Appeals on July 23, 1975. The order is printed as Appendix "C" to this Petition. This Petition is being filed within ninety days after the entry of the aforesaid order denying reargument. Jurisdiction is conferred on this Court by 28 USC §1254(1).

QUESTION PRESENTED

Did the Court of Appeals, in determining the issue of subject matter jurisdiction under the Securities Act of 1933 and the Securities Exchange Act of 1934, adopt a discriminatory and dangerous interpreta-

tion of those statutes,in conflict with the language of the statutes, the purpose impelling their enactment, the principles of international law and decisions of this Court, when it held that in connection with claims arising out of an allegedly fraudulent offering of securities,the district court lacks subject matter jurisdiction with respect to the claims of non-resident aliens, even though it has subject matter jurisdiction with respect to the identical claims of alien residents or citizens resident at home or abroad.

STATUTES INVOLVED

The statutes involved are: §§12, 15 and 17 of the Securities Act, 15 USC §§77l, 77o and 77q,and §§10 b, 15(c)(1), 20 and 30 of the Securities Exchange Act, 15 USC §§78j(b), 78o, 78t and 78dd . They are reprinted as Appendix "E" to this Petition.

STATEMENT OF THE CASE

This action was commenced as a class action in December, 1971, on behalf of all persons who purchased common stock of IOS, Ltd. (IOS) at a public offering of such stock made on or about September 24, 1969 (Public Offering)*. The complaint alleged that the prospectus pursuant to which the Public Offering was made was false and misleading in that it failed to reveal material facts concerning IOS' finances, illegal activities, chaotic bookkeeping, mismanagement and actual looting and plundering

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* The Public Offering consisted of a primary offering of 5,360,000 shares sold by IOS and a secondary offering of 5,392,000 shares sold by 490 IOS shareholders. The primary offering was managed by defendant Drexel Firestone, Inc.(Drexel); the secondary offering was managed by defendant J. H. Crang & Co. (Crang) and Investors Overseas Bank Limited (IOB). Three substantially identical prospectuses were used in connection with the Public Offering.

of IOS's treasury. Plaintiff and the class, based upon the prospectus, paid $110 million for IOS stock. Shortly after the Public Offering, the stock was worthless. Plaintiff (Petitioner) contends that if all material facts had been disclosed, the class would have known that the stock had no value and would not have purchased it.

The two leading underwriters of the primary offering were American firms, Drexel and Smith, Barney & Co., (Smith Barney) with headquarters in the United States. Both are broker-dealers, registered with the Securities and Exchange Commission (SEC). These firms, in the United States, made or participated in the making of many judgments which not only influenced but structured the entire underwriting, including the quality of disclosure. Such decisions included the determination of:

1. The size of the offering.

2. The price of the offering.

3. The firms to be invited to participate in the offering.

4. Commissions to be paid.

5. The time schedule of the offering.

6. The contents of the prospectus.

7. The adequacy of the financial statements.

8. The accuracy of the prospectus.

The participation of United States underwriters was essential to the success of the IOS Public Offering. These underwriters lent their prestige and capital to the offering and augmented its American image. The ensuing debacle directly affected the American underwriters who, as testified to by the President of Drexel, lost foreign business and, additionally, affected the integrity of the United States securities markets since American firms were so heavily implicated.

In addition to the underwriters, other American firms played major roles in the underwriting. The accounting firm of Price Waterhouse was retained by Drexel as a consultant to study and report on IOS and that firm performed significant work here. The American accounting firm of Arthur Andersen & Co. played a paramount role in the offering, placing its imprimatur upon the false financial statements contained in the prospectus.

The attorneys for the American underwriters and the issuer were also American. The New York firm of Shearman & Sterling was retained by Drexel as counsel to advise it in connection with the underwriting and, in particular, the preparation of the prospectus. Another New York law firm, Willkie, Farr & Gallagher, participated as counsel for the issuer. In addition, Stammer & Haft, New York attorneys for IOS in connection with certain matters, were consulted

with reference to the contents of the prospectus, and Edward Cowett (Cowett), a New York attorney and executive officer of IOS, was also active in the preparation of the prospectus, as well as most other aspects of the entire project.

Many key decisions were made in the United States. Drexel conducted a preliminary investigation of IOS, consulted counsel and held an exploratory meeting with the SEC here. On the basis of those efforts, which were thoroughly discussed and analyzed on a top executive level, in New York and Philadelphia, it determined to undertake the IOS underwriting.

The lead underwriters negotiated the price of the issue for the entire offering and the amount of the underwriting concession. These negotiations took place to a large extent in New York, where Bertram Coleman (Coleman), Chairman of the Board of Drexel, and Cowett of IOS agreed upon

a pricing formula and conducted a preliminary discussion on underwriting commissions. Additionally, allocation of shares to members of the syndicate was made by the underwriters in New York.

Essential to the preparation of a prospectus is a due diligence investigation of the issuer by the underwriters. A significant part of the due diligence investigation in this case took place in New York. Meetings were held in New York with attorneys for IOS and meetings were held with the SEC in an attempt to gain information about the issuer. In addition, Price Waterhouse was retained in New York to study and report on IOS. Its report was prepared, distributed and discussed in New York. That report was of extreme importance since the most significant effort to comply with due diligence was made by Price Waterhouse. That firm and, in particular, Frederic Werblow (Werblow),

the partner in charge, spent considerable effort in a review of IOS's financial operations and the proposed descriptions of those operations contained in the prospectus. The evidence indicates that approximately 50% of Werblow's work was performed in the United States. Werblow testified that he received his instructions in New York, and held meetings there with officials of IOS, Arthur Andersen and Drexel. After Price Waterhouse completed its work, an all-day meeting lasting into the evening was held in New York to discuss the IOS Public Offering. The participants reviewed and discussed all IOS financial statements. Other meetings were held in New York to report on Price Waterhouse's progress, with Andersen present and participating therein. Price Waterhouse rendered reports to Drexel laying bare the true state of IOS' operations; the reports were prepared in New York and discussed there. Those reports made known gross de-

ficiencies in the prospectus and affirmatively demonstrate that Andersen was made aware in New York of the fraudulent nature of the Public Offering.

Although much of the prospectus was drafted in Europe, certain significant parts were written in New York. These include a sticker affixed to the cover of the prospectus which referred to a proceeding brought against IOS by the SEC. Other documents prepared in New York pertain to dealings with United States companies and IOS's real estate activities in Florida.

Grayson M. P. Murphy (Murphy), a member of Shearman & Sterling, was in charge of the work to be performed by his firm.The evidence reflects that a substantial amount of Murphy's time and effort devoted to the underwriting and particularly to the prospectus, involved New York activities.

Drexel's board and executive committee, meeting either in New York or Philadelphia, were kept informed of the progress of the offering,and Murphy regularly reported directly to them.

In all the aforesaid transactions, the facilities of interstate commerce were continuously employed and the record is replete with evidence of constant international communication by virtually every conceivable form, including telephone, mail, airplane and telex.

An investigation of IOS's Florida real estate operations was made in the United States at the request of Drexel. A written report thereon was submitted to the underwriter in Philadelphia.

Publicity for the proposed offering was released in New York in violation of the antifraud provisions of the federal securities laws. During the months pre-

ceding the IOS Public Offering, defendant Cornfeld and other IOS officials touted the company's prospects in American media, such as Newsweek magazine.

American were both purchasers and sellers in the Public Offering. Bernard Cornfeld and other Americans were the principal sellers in the secondary offering. The record reflects that some 360 Americans purchased at the Public Offering. Plaintiff Bersch read all three prospectuses in New York and made his purchase here.

The closing statement for the underwriting was drafted in New York, printed in New York and distributed therefrom. All participants were directed to make payments for the stock in New York in United States dollars to "Bank of New York, 8th Floor, 20 Broad Street, New York, New York 10015."

Thus, the offering began, progressed and ended here. Although many of the tech-

nical and administrative aspects of the offering took place abroad, in the final analysis, it was directed from the United States. All of the Americans directly or indirectly involved in effecting the fraudulent enterprise profited from it - the selling stockholders, the underwriters, and the professionals, accountants and lawyers.

On defendants' motions to dismiss, the District Court found that it had subject matter jurisdiction over all claims. It determined that the primary underwriting headed by Drexel and Smith, Barney and the secondary offering headed by Crang and IOB were, in essence, one offering for purposes of subject matter jurisdiction. Further, it held, the level of activity by United States citizens within the United States in connection with that offering was of such significance, combined with some negative impact on the American market, to warrant the exercise of subject matter jurisdiction over all class

members' claims.*

The District Court, pursuant to §1292 (b), certified the issue of subject matter jurisdiction for interlocutory appeal purposes, and the Court of Appeals agreed to take the appeal.**

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* It also held that it lacked personal jurisdiction over Crang, that the manner of service and delay in service on IOS and Cornfeld did not warrant dismissal as against them and that it should not stay the action pending the winding up of IOS by Canadian authorities.

** At about the same time, defendants Andersen, Cornfeld and IOS filed appeals from a December 4, 1974 order by the District Court directing that notice be sent class members of a hearing on a partial settlement reached with defendants Drexel, Smith, Barney, Banque Rothschild, Hill Samuel, Guinness Mahon and Pierson, Heldring & Pierson, contending that such order was a determination of class action status and hence appealable under the Second Circuit's decision in Herbst v. International Telephone and Telegraph Corporation, 495 F. 2d 1308 (2d Cir. 1974) and this Court's decision in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974).

Defendants Andersen, Cornfeld and IOS moved to consolidate their appeals from the December 4 order with the instant appeals, and their motions were denied on January 29, 1975.

The Court of Appeals reversed the District Court's order insofar as it sustained subject matter jurisdiction with respect to

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[footnote continued]

Furthermore, the Court of Appeals denied defendant Andersen's motion for permission to file an outsized brief in the instant appeal on February 3, 1975. Defendant Andersen had sought to file an outsized brief in an effort to challenge the constitutionality of Rule 23 of the Federal Rules of Civil Procedure.

Despite these two indications from the Court of Appeals that it would determine the issue of subject matter jurisdiction separately from the class action issue, that court, clearly ignoring its prior actions, based its decision herein entirely on the class action aspects of the case and chided plaintiff for not coming to grips with that issue.

The class action appeal, having been effectively mooted by the Court of Appeals decision on the subject matter jurisdiction appeal, has been stayed.

all purchasers of IOS securities and affirmed it insofar as it sustained such jurisdiction with respect to purchasers who were American residents or citizens. The Court remanded the cause for modification and further consideration of the class action determination in light of its opinion.*

This Petition for Certiorari is filed in connection with defendants Arthur Andersen, IOS and Cornfeld, only.

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* The Court of Appeals also affirmed the District Court's order dismissing the complaint as against Crang for lack of personal jurisdiction and denied petitions for mandeamus by IOS and Cornfeld with respect to the manner of and delay in service of process and without prejudice, with respect to IOS' application for a stay.

REASONS FOR GRANTING THE WRIT

I.

THE EXTRATERRITORIAL REACH OF THE FEDERAL SECURITIES LAWS IS NOW A MATTER OF CONJECTURE. THIS COURT SHOULD CONSIDER THE SCOPE OF THOSE STATUTES.

The instant appeal presents important and as yet unresolved questions with respect to the extra-territorial scope of the federal securities laws. The Securities Act and the Securities Exchange Act were enacted in 1933 and 1934, respectively, many years prior to the tremendous growth of the mutual fund industry, the phenomenon of the offshore fund, the development of the large multi-national corporation and the increasing internationalization of the securities markets. Those who drafted the federal securities laws did not contemplate the complexity of modern international securities transactions and, as a result, the securities statutes fail to define their extraterritorial

reach. Accordingly, in the absence of express legislative direction, it has become the province of the courts to fill in the interstices of regulation.

The process of judicial interpretation, however, has been slow, and the results have been scant. Although the courts have valiantly sought to define the limits of the extraterritorial application of the antitrust laws for more than half a century, there has been little effort expended in a corresponding attempt to clarify the scope of the federal securities laws. Indeed, the first case to consider the extraterritorial application of the Securities Exchange Act was decided in 1960, more than 25 years after its enactment.*

There has been a dearth of judicial interpretation of the extraterritorial application of the securities laws, despite the marked increase in the number and complexity

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*Kook v. Crang, 182 F. Supp. 388 (S.D.N.Y. 1960).

of international securities transactions involving American contacts and interests. Indeed, prior to the instant case, only two major decisions, Schoenbaum v. Firstbrook* and Leasco Data Processing Equipment Corp. v. Maxwell,** have shed significant light upon the jurisdictional requisites for the extra-territorial application of the securities laws and in particular, their anti-fraud provisions. These decisions, however, have raised more questions than they have solved. Additionally, as discussed more fully below, in both Leasco and the instant case, the Congressional design with respect to jurisdiction has been divined, if not created, by a judge who,petitioner submits, articulated, not the legislative intent, but, rather, his

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*405 F.2d 200 (2d Cir. 1968), reversed on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied, sub. nom Manley v. Schoenbaum, 395 U.S. 906 (1969).

**468 F.2d 1326 (2d Cir. 1972)

own subjective perception of the "good and true."*

The within petition involves jurisdictional issues with which this Court has not directly dealt in the context of the federal securities laws. The cases decided by this Court and relied upon by the Court of Appeals dealt with jurisdictional problems arising in connection with the extraterritorial application of entirely different legislation. Thus, Steele v. Bulova Watch Co.** arose under the Lanham Act and United States v. Aluminum Co. of America,*** the antitrust laws. Although those statutes may invite some comparison with the federal securities laws, the underlying policies, as well as the nature of the problems involved, present

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*Hand, The Spirit of Liberty, (2d Ed. 1954), p.156.

**344 U.S. 280 (1952)

***148 F.2d 416 (2d Cir. 1945).

different considerations in any determination of extraterritorial reach.*

Further, the courts are in disagreement as to whether the principles espoused in the antitrust cases are applicable to the securities laws and, if so, to what extent. Thus, although the courts and commentators agree that in antitrust cases, jurisdiction may properly be based upon the presence of deleterious effects on commerce, the cases are in disagreement as to whether effect within the jurisdiction is, in and of itself sufficient to warrant the exercise of juris-

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*For example, the Lanham Act is designed to protect the individual trademark owner, whereas the securities laws are designed to protect the integrity of the United States securities markets and preserve them as a principal means of providing private investment capital for the United States economy. Although a similar purpose imbues the federal antitrust laws, i.e., the preservation and protection of the structure of the American economy, they present somewhat different problems in the international sphere, in light of differing foreign attitudes towards monopoly. Indeed, the case would appear stronger for extraterritorial application of the Securities Exchange Act than the Sherman Act, since fraud is universally proscribed, whereas foreign reaction

diction for violation of the securities laws. The Second Circuit in Schoenbaum held that federal jurisdiction did encompass a totally foreign transaction which affected stock registered on an exchange within the United States. In Leasco, however, the Second Circuit held that "despite United States v. Aluminum Co. of America... and Schoenbaum," it entertained "most serious doubt" whether, absent misrepresentation in this country, Section 10b would be applicable simply because fraud in the purchase of the securities affected an American corporation whose stock was listed on the New York Stock Exchange and its shareholders. In Travis v. Anthes Imperial, Ltd.,* on the other hand, the Eighth Circuit was "persuaded" that Section 10b would be applicable, even if it were assumed that all the fraudulent dealings took place in Canada, since the conduct outside the

(footnote continued)

to cartels is not uniform and has even included active encouragement of their use as instruments of foreign policy. See, Hexner, International Cartels, (1946).

*473 F.2d 515 (8th Cir. 1973)

country resulted in diminution in the value of stock held by plaintiffs in a Canadian corporation not listed on any American stock exchange. The court relied upon United States v. Aluminum Co. of America, Ohio v. Wyandotte Chemical Corp.* and Section 18 of the Restatement (2d) of the Foreign Relations Law of the United States.

The most extreme position with respect to the extraterritorial application of the securities laws has been taken by the SEC, the agency entrusted with their construction, implementation, and enforcement.** That agency has consistently argued, without judicial support,*** that the use of the facilities of inter-

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*401 U.S. 493, 500-501 (1971)

**"When faced with a problem of statutory construction, this Court shows great deference to the interpretaton given the statute by the officers or agencies charged with its administration", Udall v. Tallman, 380 U.S.13, 17 (1965).

***Although the Court in Leasco considered

state commerce is, in and of itself, sufficient to warrant application of the federal securities laws to a foreign transaction. That argument is based upon the theory that the United States has a direct interest in the use to which the facilities of interstate commerce are put and that any fraudulent use of such facilities warrants extraterritorial application.*

Thus, it is apparent that the law in this area is both unsettled and confused. Petitioner believes that it is of supreme importance that this Court express its views on the issue of the extraterritorial reach of the federal securities laws. In recent years, international securities trading has increased phenomenally. United States citizens invest large sums in foreign

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(footnote continued)

the use of the facilities of interstate commerce to constitute conduct within the United States, it did not agree that such use, however incidential, would warrant the exercise of jurisdiction.

*See SEC v. United Financial Group, Inc. 474 F.2d 354 (9th Cir. 1973).

securities,and foreigners invest in American securities markets, particularly through the medium of large foreign-based mutual funds. Additionally, it is anticipated that such transactions will proliferate as the world moves toward a common market in securities. The barrier of distance which served to confine securities transactions to a single country no longer exist,and some degree of diversification is now accepted by investors. Today, sophisticated communications systems and computers, combined with such factors as the stabilization of the foreign exchange markets, have enabled investors throughout the world to trade on and invest in numerous foreign markets with a high degree of speed and ease.

In disputes arising from international securities transactions, litigants of all nationalities must depend upon national courts to adjudicate controversies involving international facts. Petitioner submits that the United States has a peculiar responsibility of leadership because of its

paramount position in the world's securities markets to formulate acceptable standards of conduct in securities transactions involving Americans and affecting American interests. A decision by this Court defining the reach of the federal securities laws would go far toward putting "on notice" both Americans and foreigners engaged in international securities transactions as to what conduct and circumstances American courts will deem sufficient to warrant the exercise of jurisdiction.*

II

THE DECISION OF THE COURT OF APPEALS WAS ERRONEOUS AND WILL HAVE SERIOUS CONSEQUENCES, UNDERMINING THE EFFECTIVENESS OF THE FEDERAL SECURITIES LAWS IN THIS AGE OF INCREASING TRANSNATIONAL ACTIVITY.

The instant petition presents for review important issues with respect to the

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*Subjecting an offender to rules that are uncertain raises a question of due process--fairness.

extraterritorial reach of the federal securities laws. The case derived from an international securities transaction, massive in size, complex in concept and execution, involving all of the various factors previously deemed critical in the jurisdictional calculus. In a simplistic opinion, fundamentally based upon a concern with nationality and an antipathy toward class actions, the Court of Appeals determined that while under recognized principles of international law, Congress could have empowered the District Court to exercise jurisdiction, Congress would not have wished to do so.

Although the Court of Appeals assertedly sought to determine "what Congress would have wished," it "freely acknowledged that if [it] were to point to the language in the statutes, or even in the legislative history, that compelled [its] conclusions, [it] would be unable to respond." Thus, as the Court

stated, its determination of Congressional intent rested upon case law, commentary and its "own best judgment." In the adjudicative mix, petitioner contends, the latter was the primary ingredient.

While it may well be true that Congress did not "foresee the development of off-shore funds" at the time the federal securities laws were enacted, it does not follow that the statutes, themselves, are unhelpful in determining Congressional intent. In reaching its decision, however, the Court of Appeals ignored the principles of sound statutory interpretation and premised its opinion primarily upon the prejudices of its author with respect to class actions. The conclusions of the court are unsupported by statutory language, run counter to the very fabric of the securities laws, and, petitioner submits, if allowed to stand will constitute erroneous and dangerous precedent.

A. The Court Did Not Truly Seek the Congressional Intent, But Rather, Substituted its Own View as to What Such Intent Should Have Been

> "In construing a statute whose meaning is not clear, the first inquiry is one as to legislative intent, pursuant to the obligation of giving effect to the plain purpose of the statute ... Legislative intent has no reference to what may have been in the mind of the person who wrote the statute, or whether there was anything in particular in the minds of individual legislators who voted for its enactment. Intent as here used relates to the purpose to be served by the statute, and the statute is to be looked upon as if some unified legislative spirit motivated its enactment."*

To discover this mind or spirit in the absence of clear legislative history, resort should be had to an examination of the conditions comprising the background of legislative action and the language of the statute itself. Thus, the statutory language and legislative purpose are the principal determinants in a search for Congressional intent.

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*Day v. North American Rayon Corp., 140 F. Supp. 490, 491 (W.D. Tenn. 1956) (citations omitted)

The mere fact that Congress did not anticipate the tremendous changes in the milieu of securities transactions does not vest the court with unbridled authority to guess what the legislative "would have intended on a point not present to its mind, if the point had been present."* As one commentator has noted, "what a legislator did think of makes a difference. But what he did not think of does not make a difference unless he would have excepted it had he thought of it."** The difficulty, of course, lies in determining "whether he would have excepted it" and in many instances, that question "may have no decisive answer."*** However, in the instant case, the conduct

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*Cardozo, The Nature of the Judicial Process, 15 (1921) quoting Gray, Nature and Sources of the Law, §370, p. 165

**McCallum, Legislative Intent, 75 Yale L.J. 754, 773 (1966) (emphasis in original)

***Loc. Cit.

which Congress intended to except has been explicitly articulated in the language of the statute and this provision, coupled with an examination of the circumstances compelling the statutory enactment, reveals that the Court of Appeals, rather than effectuating the Congressional intent has seriously subverted it.

1. Congressional Intent Is Revealed By the Language and Purpose of the Securities Laws.

a. The Statutory Language.

The language of the Securities Exchange Act of 1934, 15 U.S.C. §78a et seq. (Exchange Act) indicates that Congress intended to extend the protection of the United States law to foreigners injured in violation of such laws. Where a particular statutory view cannot be determined with precision, the court will look to the statute itself, to find "legislative intent."* "It

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*Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 412 n. 29 (1971).

is no bar to interpreting a statute as applicable that 'the question which is raised on the statute never occurred in the legislature'",* and the"absence of any legislative history in point should not outweigh the words of the statute."**

An examination of the language of the federal securities statutes indicates that Congress addressed a perceived need to regulate extraterritorial activity of Americans and foreigners which has a substantial impact upon United States commerce. Contrary to the Court of Appeals' erroneous conclusion that Congress did not consider the application of the securities laws to foreign transactions, these laws, themselves, evidence the fact

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*Eastern Airlines, Inc. v. CAB, 122 U.S. App. D.C. 375, 354 F.2d 507, 511 (1965) citing Cardozo, loc. cit.

**Souder v. Brennan, 367 F. Supp. 808, 812-813 (D.D.C. 1973).

that Congress gave such matters serious thought and, indeed, intended the securities laws to have extraterritorial effect. Thus, the subtitle of the Exchange Act is "an act to provide for the regulation of securities exchanges and all over-the-counter markets operating and in interstate and foreign commerce and through the mails to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes." (emphasis supplied)

In defining "interstate commerce", Congress included instrumentalities of foreign countries as well as traditional interstate means. In Section 30(b)* Congress made clear what it would have "excepted," exempting foreign broker-dealers who engaged in securities wholly without the jurisdiction of the United States. Thus, there arises the clear inference that Congress intended that Americans and foreign persons not wholly without the jurisdiction of the United States not

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* 15 U.S.C. §78dd(b)

be exempt from the Exchange Act. Implicit in the decision to give a limited exemption is a recognition by Congress of the objective territorial principle and the fact that foreign transactions can adversely affect domestic markets. Accordingly, the statute clearly reflects the Congressional will that foreign transactions, unless exempt, be subject to the federal securities laws. In Schoenbaum, the court adopted this view stating:

> "Indeed, since Congress found it necessary to draft an exemptive provision for certain foreign transactions and gave the Commission power to make rules that would limit the exemption, the presumption must be that the Act was meant to apply to those foreign transactions not specifically exempted." 405 F.2d at 208.

Thus, the court in Schoenbaum, viewed §30b as a kind of affirmative mandate for extra-territorial application of the Exchange Act.

Additionally, in Section 30(a)* Congress delegated authority to the Securities

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*15 U.S.C. §78dd(a).

and Exchange Commission (SEC) to adopt rules to regulate the conduct of U.S. broker-dealers in transactions occurring abroad. It is significant that although the SEC, the agency entrusted with the administration of the securities laws, which has developed an unparalleled expertise in interpreting and enforcing them,* alone, was given the power to limit or define their reach to foreign transactions, the Court of Appeals arrogated to itself that Congressional grant of power.

Regretably, the court failed to utilize an elementary tool of statutory interpretation, ignoring the very language of the statute and its meaning as recognized in

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*It is further significant that although the court believed its opinion to be unprecedented and unsupported by legislative history, it did not seek advice from the SEC. Had it sought the opinion of that agency, the record in this case clearly reflects that it would have been advised that the SEC considered the antifraud provisions of the securities laws not restricted to Americans or United States residents and that such provisions attached to the challenged transaction herein.

Schoenbaum*, substituting instead its own artificial and discriminatory categories.

b. The Congressional Purpose Will Be Frustrated By Permitting the Decision of the Court of Appeals to Stand.

A court faced with the problem of statutory interpretation must examine not only the statutory language but also its aim since "[a]rguments of policy are relevant, when, for example a statute has an hiatus that must be filled or there are ambiguities in the legislative language that must be resolved."** In such case, the court should attempt "to discern and articulate the provision's purpose."*** Thus, the distillation of a statute's basic purpose

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*Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968), reversed on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc) cert. denied sub. nom Manley v. Schoenbaum, 305 U.S. 906 (1969).

**Unexcelled Chemical Corp. v. United States, 345 U.S. 59, 64 (1953).

***Eck v. United Arab Airlines, Inc., 360 F.2d 804, 812 (2d Cir. 1965).

is necessary in any application of existing law to new conditions not dealt with in express terms.

It has been stated that "[t]he broad goal of U.S. securities laws is the promotion of securities markets whose integrity and reliability will protect investors and warrant their confidence.* The United States has long been committed to the maintenance of a domestic securities market in which all investors can participate without fear of being defrauded. As foreign investment in American markets increases, the interests of the United States in preserving the integrity of such markets from foreign wrongdoing mounts. Thus, in denying recovery to foreigners, the Court contravenes the statutory purpose, since the publicized exploitation of foreign investors by Americans in a transaction structured here adversely

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*Comment, 52 Tex. L. Rev. 983 (1974).

affected American markets. It is virtually undisputed that the shadow of disreputable activity cast by the American defendants fell upon American securities markets.* The resulting loss of foreign business was a direct and foreseeable result of defendants' activities at home and abroad in connection with the IOS offering. That it constituted a result which Congress sought to avoid cannot, petitioner submits, be fairly disputed and, accordingly, the Court had Congressional authority to administer the necessary remedy.

The decision of the Court, however, indicates a lack of awareness of the "mischief" which the securities laws were "meant to remedy" and a failure to consider the statutory purposes. The circumstances of this case present one of the very situations

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*The Court fails to distinguish between the direct "effects" caused by the participation of American principals in the securities markets in the fraud alleged and the general "effects" upon American markets resulting from the subsequent collapse of IOS, apparently lumping both together.

Congress sought to prevent by enactment of the Securities Exchange Act of 1934. Section 30(b) of that Act focused upon the single standard of "evasion." That section was intended to prevent evasion of the securities laws by devices to circumvent their application. Thus, the American broker-dealers, accountants and sellers who structured a fraudulent transaction here should not be permitted to escape liability to foreigners on the ground that they deliberately took pains to confine certain legally significant portions of their fraud to foreign shores so as to evade application of the securities laws.

It is one of the "ancient canons of interpretation that the old law, the mischief and the remedy must be considered by the judge and that the statute under consideration must be given an interpretation which will suppress the mischief and advance the remedy."*

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*Newton v. Employers Liability Assurance Corp., 107 F.2d 164, 167 (4th Cir. 1939), cert. den. 309 U.S. 673 (1940) (Parker, Circuit Judge).

It is the judge's duty "to suppress subtle inventions and evasions for the continuance of the mischief."*

This venerable maxim was endorsed by Dean Landis who observed:

> "A thorough understanding of the process underlying the statute will often give a clue as to the influence that it deserves. 'Mischiefs,' as Coke said, are often responsible for legislative action and are the key to its meaning. The consequences of the mischief may only have been appreciated by the legislature in a limited field and patent abuses alone eliminated. But thorough understanding of the statute enables one to pierce through the specific remedial measures to a concern with the causative influences that made action necessary. On the other hand, statutes may represent merely a rectification of the existing pattern of the law without striking at its deeper assumptions. Yet even rectifications, sufficiently abundant, may, like the empiric process of adjudication, spell out an attitude of more moment than the manifestations themselves, and thus bring into being a policy calling for a fuller realization."**

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* Miller v. Lykes Bros. S.S. Co., 467 F. 2d 464, 467 (5th Cir. 1972); Burstein v. United States Lines Co., 134 F. 2d 89, 93 (2d Cir. 1943).

**Statutes and the Sources of Law, 2 Harv. J. Legis. 7, 22 (1965)

It cannot be gainsaid that the federal securities laws are remedial in nature and should be given a liberal interpretation.* This Court has continually held that Congress enacted the securities laws for the purpose of preventing fraud and intended that they be construed "not technically and restrictively, but flexibly to effectuate [their] remedial purposes."** Rather than effectuate the Congressional purpose, however, the Court of Appeals' decision serves notice that American broker-dealers, accountants, issuers and sellers can defraud foreigners with impunity if they can manage to accurately "draw the line between essentially preparatory and actual fraudulent devices conducted in the U.S.,"***

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*Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

**Affiliated Ute Citizens v. United States, supra, at 151; Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 12 (1971); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

***Brodsky, Corporate and Securities Litigation: The Reach of Federal Securities Laws Over Foreign Transactions, N.Y.L.J.,(May 7, 1975).

B. The Court of Appeals Opinion If Allowed to Stand Will Cause Confusion Over The Validity of Accepted Principles Regarding Jurisdiction Previously Approved By This Court.

It has been generally accepted that the principles of international law set only the outer limits of the securities laws' transnational reach, permitting a court to find that Congress intended to stop short of these limits. However, if as the Court of Appeals contends, there is an absence of evidence as to the actual Congressional intent, the court is left "with no basis except sheer speculation, for finding that Congress intended to stop short of the limits imposed by international law." In such a situation, therefore, "[t]he result is that the principles of international law function as more than mere benchmarks."*

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*Comment, The Transnational Reach of Rule 10b-5, 121 U. Pa. L. Rev. 1363, 1370. (1973). Although the Court of Appeals professed reliance upon commentary in reaching its decision, including the above cited comment, it either ignored or rejected the

The Court of Appeals, however, declined to believe that Congress intended to exercise its full power. Thus, it refused to equate the Congressional intent with the limits of international law and restricted the transnational reach of the securities laws in an opinion which "clarifies neither the source nor the scope of these limitations."* Moreover, in so doing, it misinterpreted and misapplied the basic principles of international law.

(footnote continued)

author's conclusions. The comment stated that a plaintiff who was "able to sift through the complex facts of a transnational security sale and point to elements which satisfy one or more principles" of international law would be "in a good position to satisfy his jurisdictional claim." The Court of Appeals, however, in this case as in Leasco, sought "to impose limits on the reach of Section 10(b) short of the boundaries established by international law." The comment noted "the lack of any expressed policy justification for the limits suggested by the court" in Leasco. Similarly, in the instant case, the limitation was based on no substantial policy considerations, but, rather, on a desire to destroy the class action device.

* Ibid. at 1382.

1. The Effects Doctrine Was Erroneously Applied By Misinterpretation of Precedent Laid Down by This Court.

As petitioner has discussed above, the export by Americans of the fraudulent IOS offering impaired the confidence of many foreign investors in American securities and American securities markets. As a direct result of the participation of Americans in a fraud of monumental proportions, conceived and initiated in the United States, the integrity of the American markets was impaired and the flow of capital to American business impeded. The worldwide publicity revealing Americans, identified with American securities markets, as the principal wrongdoers in a scheme to defraud foreign investors, led to a global loss of confidence in American securities markets. The impact upon such markets was undoubtedly far greater than impact previously held sufficient to justify the assertion of jurisdiction, for example, the minimal "reduction in equity" of some Americans in a Canadian corporation caused by the totally foreign transaction between foreign

entities in Schoenbaum, supra. The Court of Appeals, however, contended that such impact, even if acknowledged, would not bring the transaction within the objective territorial principle holding that domestic effects were not, as in Schoenbaum, the direct result of the wrongful conduct complained of, and, in addition, were not intended. In both contentions, the court is in error.

The intimate involvement of prominent Americans in a large international securities fraud launched from the United States necessarily adversely affects domestic markets, the very interest the securities laws were designed to protect. In discussing the "effects" issue, the court again failed to consider the purpose of the securities laws. It distinguished the result in Steele

from that herein because in the former case, there was a direct effect upon Bulova, the owner of a trademark, as a result of the defendant's infringement activities. The Court stated that nothing in the Steele opinion indicates that this Court would have found jurisdiction if all that had been proved was that the unlawful activity gave the American watchmaking industry a bad name in foreign countries. However, that distinction ignores the fact that the Lanham Trademark Act was specifically intended to protect neither industries nor markets, but specific individuals, i.e., owners of trademarks, whereas the securities laws were aimed in large part at American securities markets as a whole. Accordingly, fraudulent conduct which reflects adversely upon the integrity of such markets in foreign countries, thereby discouraging foreign investment here, is clearly not only within the ambit of international law, but also the Congressional purpose.

Further, the principles of international law do not require that to confer jurisdiction, "effects" must be intended. Judge Learned Hand's limitation on the effects doctrine followed by the Court of Appeals was superfluous, unsupported by prior law and disregarded after its articulation. Since the rule had long been established in antitrust cases that persons are presumed to intend the natural consequences of their acts, evidence of "effects" likewise evidenced the required intent. The courts after the United States v. Aluminum Co. of America* decision, have not refused to assume jurisdiction in cases of lack of intent, even where proven.**

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*Supra.

**See, e.g., United States v. National Lead Co., 63 F. Supp. 513, 518, 527 (S.D.N.Y. 1945) aff'd. 332 U.S. 319 (1947); United States v. Minnesota Mining & Mfg. Co., 92 F. Supp. 927, 958 (D. Mass. 1950); United States v. Timken Roller Bearing Co., 83 F. Supp. 284, 310 (N.D. Ohio 1949), aff'd. 341 U.S. 593 (1951); see also Thomsen v. Cayser, 243 U.S. 66, 86 (1917).

Additionally, the language of the Restatement (Second) of Foreign Relations Law of the United States, §18, cited by the Court, dealing with "effects" does not represent an accurate expression of international law and is unsupported by the "cases, authorities and the practices of states."* Indeed, the limitations contained in Section 18 were not present in the Tentative Draft and no valid justification** has been suggested for their inclusion in the final product. The Tentative Draft provided in pertinent part:

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*Metzger, The Restatement of the Foreign Relations Law of the United States: Bases and Conflicts of Jurisdiction, 41 N.Y.U. L. Rev. 7, 16 (1966).

**Prof. Metzger contends that "oil companies with international interests" mounted an attack which resulted in the change. loc. cit.

"§8. Jurisdiction to Prescribe Based on Territory: Conduct Relating to Territory

A state has jurisdiction to prescribe rules attaching legal consequences to conduct, including rules relating to property, status or other interests with respect to conduct occurring:

(a) In its territory;

(b) Partly within partly outside its territory;

(c) Entirely outside its territory, if the conduct has, or is intended to have, effects within its territory which have a reasonably close relationship to the conduct."

The Draft remains an accurate statement of the law.*

2. The Court Erred in According Jurisdictional Significance to the Distinction between Preparatory and Operative Acts, Ignoring Precedents of this Court to the Contrary.

The Court of Appeals held that the securities laws did not apply to foreign

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*Modern legislation, draft codes, projects and resolutions make "no distinction between an act and an omission to act or between an intended act or unintended result." Research in International Law: Jurisdiction With Respect to Crime, 29 Am. J. Int'l L., Special Supplement 434 (1935).

nationals resident abroad because the acts of the defendants in the United States in furtherance of the fraud, were "preparatory" in nature and the actual fraud, that is, the dissemination of the false prospectuses, primarily occurred abroad. However, petitioner submits, under the circumstances of this case, the distinction drawn is without meaning.

Petitioner alleged in the complaint that prior to their involvement in the fraud, the American defendants "knew the facts" which had caused others to decline participation in the underwriting and with knowledge of the fraudulent nature of the offering, nevertheless, determined to take part in it. Accordingly, everything done by the defendants to further the unlawful enterprise constituted illegal conduct.* The jurisdictional effect of the transaction should "not be

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*Petitioner also stated in the complaint that the existence of a conspiracy was a common question of fact.

judged by dismembering it and viewing its separate parts, but only by looking at it as a whole."*

Further, as the University of Pennsylvania comment cited by the Court of Appeals has accurately noted:

> "The requirement that the actual misrepresentations which form the basis for the 10b-5 claim be made within the United States fails to take account of the nature of transnational securities dealings. These dealings usually touch upon the territory of more than one nation, and whether a particular misrepresentation is made in one country or another is often a matter of chance. The jurisdiction of a state should not turn on such chance occurrences, for the interest of the state is identical whether or not the particular misrepresentation is made within the state. The requirement that conduct within the territory be significant, or an essential link in the transaction, is better-suited to protecting the interests of a state in regulating conduct within its borders."**

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*Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 699 (1962).

**121 U. Pa. L. Rev. at 1375.

C. The Court of Appeals Distorted the Significance of Nationality

The Court of Appeals determined that the scope of §10b reached Americans residing abroad, but not foreigners (in a class action) who were defrauded under identical circumstances. In reality, the court based its decision upon the American nationality of the plaintiff, a condition which it also found necessary to recovery in Leasco.* Thus, the Court subscribed to the passive personality principle, a doctrine which has been rejected by the United States.**

Not only did the court place paramount stress upon the nationality of the plaintiff, a factor generally deemed insufficient for

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*The similarity between Leasco and the instant case, is as petitioner has elsewhere suggested, the result of the influence of Judge Friendly upon the Court of Appeals in the jurisdictional area and the decisions in those cases represent his personal views.

**See Restatement (Second) of Foreign Relations Law of the United States. (1965).

jurisdiction, but it ignored the nationality of the defendants, which unlike that of the plaintiff can, in and of itself, provide a proper basis for the assertion of jurisdiction. Indeed, the nationality principle has achieved universal acceptance by members of the international community and "under existing international practice, a State is assumed to have practically unlimited legal control over its nationals."*

The United States has adopted the principle that the privileges and protection of American citizenship carry with them a duty to conform to certain standards of conduct. In particular, our government has asserted jurisdiction to punish nationals for crimes committed abroad. The courts have likewise recognized this principle in deter-

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*Research in International Law: Jurisdiction with Respect to Crime; 29 Am. J. Int'l. L. Spec. Supp., 435, 519, 520. (1935)

mining application of the securities laws. In SEC v. Gulf Intercontinental Finance Corp.*, the Court looked through "the transparent fabric" of the challenged transaction and concluded that the true issuers of the securities involved were Americans who used a Canadian corporation as "a conduit for the securities to be issued by the Florida defendants." Although the Court did not specifically base its finding of subject matter jurisdiction upon the nationality of the defendants, the facts of that case indicate that it was a determinative factor in the decision. In SEC v. United Financial Group, Inc.,** the nationality of the defendant, a Delaware corporation, was deemed a critical factor which, coupled with the fact that some Americans were allegedly defrauded and the mails and other facilities of interstate commerce of the United States were

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*223 F. Supp. 987, 995 (S.D. Fla. 1963).

**Supra.

used, provided "sufficient evidence for subject matter jurisdiction" under the American securities laws.*

In the instant case, the principal defendants are American. Defendants Drexel and Smith, Barney are United States corporations, maintaining their principal executive offices in the United States. Both are registered with the Securities and Exchange Commission as broker-dealers and are members of the National Association of Securities Dealers, Inc. These defendants

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*See also Waddell & Reed, Inc., CCH Fed. Sec. L. Rep. ¶79,049 (Securities Exchange Act Rel. No. 9790, 1972).

**See also, Finch v. Marathon Securities Corp., 316 F. Supp. 1345 (S.D.N.Y.1970), in which the Court found that the fact that six of the defendant fund's eight directors were Americans partially bridged the jurisdiction gap.

constituted two of the six principal underwriters of the primary offering and their names appeared on the cover of the main prospectus. Drexel assumed the lead position and underwrote the largest number of shares (478,000). Twenty-five additional American firms participated in the underwriting. Shares underwritten by Drexel and Smith, Barney totalled over $8,000,000, the entire American underwriting over $15,000,000. Defendant Arthur Andersen, the accounting firm which played such an important role in the preparation of the prospectus, is also an American firm. Major American law firms rendered legal advice in connection with the underwriting and in particular, the preparation of the prospectus.

Although IOS was a foreign based corporation, its image was that of an American

company.* Its president, defendant Cornfeld, its chief operating officers and many of its employees were Americans. It had formerly operated various subsidiaries in the United States, at the time of the offering was conducting a real estate enterprise in Florida, and its funds, managed by Americans, were trading heavily in American securities. Such close contact with the United States caused IOS to be viewed abroad as an American entity.

The United States has consistently treated as domestic corporations certain companies incorporated in foreign countries, but having substantial financial links with the United States and American citizens in important management positions.** Add -

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*A State has competence to exercise jurisdiction over juristic persons, including corporations, having said State's national character. Research in International Law; Jurisdiction with Respect to Crime, 29 Am. J. Int'l. L. Spec. Supp. 435, 538.

**See Foreign Asset Control Regulations.

itionally, registration with American regulatory agencies has been deemed of crucial importance. The SEC has taken the position that American broker-dealers by virtue of their registration are subject to the anti-fraud provisions of the Exchange Act. In the instant case, the SEC advised Shearman and Sterling, counsel for defendant Drexel, that the anti-fraud provisions of the Exchange Act would be applicable to the activities of a registered broker-dealer participating in an underwriting outside of the United States of a security not registered under the Securities Act of a foreign issuer to be offered and sold to foreign nationals only.*

The American nationality of the defendants was of singular importance in the

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*The SEC thus, recognized that while the United States might not wish to police the conduct of its citizens abroad in every business sphere, the Congress has specifically sought to regulate the conduct of American broker-dealers in securities transactions. Accordingly, registration with the SEC subjects the activities of such broker-dealers to regulation, wherever they may occur.

instant case, since their American identity was both a source of investor confidence in the Public Offering and disillusionment after its collapse. The exploitation of foreign nationals by American broker-dealers and accountants reflected adversely upon the United States securities markets and United States brokerage firms who were active in selling securities abroad. The IOS fraud, identified as American, resulted in a deterioration of investor confidence in American underwriters at home and abroad. "The false and misleading prospectus used in connection with the Public Offering impaired investors' confidence and trust and contributed to a steep decline in the purchase of U.S. securities by foreigners."*

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*Affidavit of Morris Mendelson, Associate Professor, Wharton School of the University of Pennsylvania, referred to in the Court of Appeals' opinion.

Thus, the fraud of Americans directly affected the integrity of American markets. It is the United States' interest in protecting the integrity of its securities markets in order to promote the free flow of capital to American business which provides a sound basis for the assertion of subject matter jurisdiction.

Accordingly, the Court of Appeals erred in overemphasizing the importance of the American nationality of the plaintiff and other American class members, while ignoring the extreme significance of the defendants' nationality, a factor which has always been accorded substantial weight in the jurisdictional scheme.*

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*In Steele v. Bulova Watch Co., supra, the court deemed significant the fact that acts of trade-mark infringement and unfair competition were consummated abroad "by a citizen and resident of the United States." at 281. In Bartholomew v. Universe Tankships, Inc., 263 F.2d 437 (2d Cir. 1959), in considering the applicability of the Jones Act to an assault on a citizen of

D. The Opinion of the Court of Appeals Written by Judge Friendly Constituted a Legislative Act Designed to Deal with the "Class Action Problem".

Judge Friendly has always stressed the legislative aspect of the judicial function, believing that upon his elevation to the bench, he "suddenly [became] a legislator, exercising power over generations yet unborn."* His strong belief that Congress has in many areas "failed to perform its legislative task"** has undoubtedly impelled him to undertake, himself, the lawmaking function so as to achieve the scheme of society which he entertains. Judge Friendly

(footnote continued)

the British West Indies, the court, "pursuant to the liberal policies of a regulatory act" looked "through the facade of foreign registration and incorporation to the American ownership" of the defendant corporation which, in turn, owned the vessel on which the assault occurred. See also, Hellenic Lines Limited v. Rhoditis, 398 U.S. 308 (1970).

*Friendly, Reactions of a Lawyer - Newly Become Judge, 71 Yale L.J. 218, 219 (1961).

has subscribed to the theory that judges should be free to impose their views of what they think desirable, quoting, with approval, the words of Learned Hand:

> "When a judge tries to find out what the government would have intended which it did not say, he puts into its mouth things which he thinks it ought to have said, and that is very close to substituting what he himself thinks right...."*

Petitioner recognizes that in some cases, particularly those in which the legislative intent cannot truly be discerned, a judge is left with a choice which permits the exercise of judicial creativity. However, petitioner submits, in this case there is a glaring contradiction between what Judge

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*Friendly, The Gap in Lawmaking - Judges Who Can't and Legislators Who Won't, 63 Colum. L. Rev. 787, 801 (1963).

**Hand, The Spirit of Liberty, 108-10 (2d Ed. 1954), cited in Friendly, The Gap in Lawmaking - Judges Who Can't and Legislators Who Won't, supra, at p. 798.

Friendly deems desirable and both the Congressional intent impelling the enactment of the securities laws and the Federal Rules of Civil Procedure. In this decision, Judge Friendly arbitrarily chose to hold that Congress did not intend to protect foreign nationals who sued as members of a class. A choice implies motives,and one can easily identify the motive which led Judge Friendly, in rendering his decision, to ignore the accepted methodology of statutory interpretation. The language of the decision itself reveals Judge Friendly's antipathy towards the class action device. The opinion initially notes with disfavor the "added complexity" inherent in "a class action on behalf of thousands of plaintiffs preponderantly citizens and residents of Canada, Australia, England, France, Germany, Switzerland and many other countries in Europe, Asia,Africa, and South America." The opinion

describes the complaint as one containing "the allegations usual when a plaintiff desires designation of his action as a class action under Fed. R. Civ. P.23(b)(3)." The Court states that Congress did not mean the United States to be used as a base for fraudulent securities schemes even when the victims are foreigners "at least in the context of suits by the SEC and by named foreign plaintiffs." However, "unhappily", says Judge Friendly, this was not a single action with named plaintiffs, but rather, a class action with many thousands of class members.

In reaching out to decide the class action issue, Judge Friendly based the Court's authority upon totally inapplicable precedent and the fact that the order appealed from had been rendered in a class action. He decided in effect, that on any interlocutory appeal in a class action, the court is not limited to the question certified, but may sua sponte

delve into the appropriateness of prior class action certification, even though such issue were not before it.* The Court gave only the most superficial consideration to the class action issue, focusing mainly on what it saw as the "tremendous burdens" imposed by a class action whose members are "predominantly

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*Class action status was previously granted herein by Judge Frankel, and the order granting such status was not appealed. A motion to review class action status was made before Judge Carter, and the motion remained undetermined by him at the time of his decision of the jurisdictional issues. Despite Judge Carter's specific statement that the class issue had not yet been resolved by him, the defendant Andersen sought to portray Judge Carter's jurisdictional decision as a class action decision in disguise and, accordingly, filed a notice of appeal thus, creating a bogus class action issue which it asserted could be heard as a matter of right. Defendant Andersen served its brief on the class action issue, and petitioner had prepared an extensive answering brief on that appeal which was rendered moot by Judge Friendly's gratuitous decision. That appeal has since been stayed.

abroad." It made no attempt to examine the scope of the manageability problem and totally ignored the benefits to be derived from the maintenance of a class action. The result was a decision against class actions per se, rather than an adjudication of jurisdictional issues. Judge Friendly articulated his subjective perception of the "good and true", seizing upon a unique opportunity to undermine class actions which he strongly believes have become "a matter that needs urgent attention". A judge who has refused to accept the class action concept, has little sympathy for those with "$50 claims" and who considers the settlement of class actions "blackmail"* has, by a feat

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* Eisen v. Carlisle & Jacquelin, 479 F.2d 1005, 1020 n. 28 (2d Cir. 1974), quoting Friendly, Federal Jurisdiction: A General View. 120 (1973).

of judicial legislation, dealt class actions a stunning blow.*

Judge Friendly's prejudice can be seen from the fact that he rendered a class action opinion without receiving the views of the appellee on the issue, a course which the appellee deems highly prejudicial, especially in light of the procedural stance of the appeal at the time the decision was rendered. Although the court had previously denied the appellant's motion to consolidate the appeal of class action issues with that of jurisdiction or to permit the appellant to submit an oversize brief so as to present class action issues, Judge Friendly seemed surprised that the appellee failed to comprehend that when the court twice said "no", it really meant "yes".

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*Not only does the elimination of foreign class members emasculate the class, but the making permanent of the stay renders settlement of a class action in which jurisdiction is challenged by a non-settling defendant impossible at any stage short of an adjudication by the United States Supreme Court.

It is clear that Judge Friendly based his decision not on the over-all dimensions of the security transaction in question, but solely upon the class action issues allegedly created by the presence of foreign members in the class, thus, distinguishing the case from prior decisions of the Second Circuit, Schoenbaum and Leasco, which did not raise "serious problems" of a class action nature. Judge Friendly indicates that a different jurisdictional result would have been found if the suit had been "by the SEC or by named foreign plaintiffs." Accordingly, by judicial legislative fiat, Judge Friendly determined in this case that foreign nationals residing abroad are, by virtue of their foreign residence, disqualified as members of a class and, accordingly, a district court lacks jurisdiction over their claims based upon violation of the securities laws, if such claims are presented by means of the class action device. Not only does such a

position find no support in either statutory law or the federal rules, but the decision is an illogical if not an irrational one. The Federal Rules of Civil Procedure cannot expand the scope of the jurisdiction of the Federal Courts beyond that conferred by Congress,nor can they contract the scope of that jurisdiction. "The issue of the power of the Court to bind foreign members of a class living abroad is difficult, unsettling, and may, in and of itself, lead to the conclusion that foreigners living abroad should not be members of the class, but that issue is unrelated to the question of the intent of Congress relating to the off-shore reach of the securities laws."*

Thus, the basic unsoundness of the decision of the Court of Appeals can be

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*Brodsky, Corporate and Securities Litigation: The Reach of Federal Securities Laws Over Foreign Transactions, N.Y.L.J.(May 7, 1975),pp. 1, 4.

explained by its underlying purpose--the frustration of class actions. The conclusions reached are grounded upon the erroneous application of international law, bolstered by faulty analysis of relevant judicial precedent and characterized by a parochial outlook, unresponsive to the problems created by the phenomenal growth in international securities trade and insensitive to the rights of individuals in a world of ever increasing transnational interaction. A decision which attempts to destroy class actions by emphasis upon citizenship as a source of rights is both dangerous and ill considered.

Judge Friendly has failed to follow the advice of Judge Learned Hand with respect to statutory interpretation rendered many years after his words quoted above.

> "[B]efore and beyond all the [judge] must purge his mind and will of those personal presuppositions and prejudices which almost inevitably invade all human judgments; he must approach his

> problems with as little preconception of what should be the outcome as it is given to men to have; in short, the prime condition of his success will be his capacity for detachment.'*

That sentiment was also expressed by one commentator who observed "that strong judges prefer to override the intent of the legislature in order to make law according to their own views," perpetrating grave sins "in the name of the intent of the Legislature." To condone "the practice of talking in terms of the intent of the legislature. . . when it is apparent that the intent is that of the judge, is to condone atavistic practices too reminiscent of the medicine man."**

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*The Spirit of Liberty, supra, 165.

**Landis, A Note on Statutory Interpretation, 43 Harv. L. Rev. 886, 890, 891 (1930).

However, "strong judges are always with us; no science of interpretation can ever hope to curb their propensities, but the effort should be to restrain their tendencies not to give them free rein in the name of scientific jurisprudence."* Nevertheless, at the least, creative judges should "hold to a 20th century economic and social philosophy and not to a long outgrown philosophy."** It is obvious that Judge Friendly would turn the clock back to the days before class actions,*** thus placing large scale injuries beyond legal redress. However, "[t]he need for group remedies is not new and has grown more acute

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*Id. 891.

**Hicks, Organization and Ethics of the Bench and Bar, 171 (1932) quoting Theodore Roosevelt.

***A long way, since as early as 1820, Justice Story approved the representative action. West v. Randall, 29 Fed. Case. 718, 720-22 (No. 17,424) (C.C.D. R.I. 1820).

as commercial and social transactions have increased in complexity and dispersion ."* Thus, "[w]hat life needs, the law must reckon with."**Class action litigation has become a valuable part of the American judicial process and it should not, plaintiff submits, be vitiated in the name of a fictitious Congressional intent.

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*Note, Federal Class Actions; A Suggested Revision of Rule 23, 46 Colum. L. Rev. 818 (1946).

**Brown, Electronic Brains and the Legal Mind: Computing the Data Computer's Collision with Law, 71 Yale L.J. 239, 254 (1961).

CONCLUSION

The issues herein presented are of increasing importance, as the securities markets of the world grow more interrelated. The decision admittedly represents not the views of Congress, but those of one appellate panel. That decision, by permitting the evasion of liability in an international securities transaction by the strategic placement of fraudulent actions, encourages the exploitation of foreign investors and the flouting of American law. It is, therefore, important that this Court reaffirm the principles behind the federal securities laws by upholding

subject matter jurisdiction with respect to the claims of the entire class. Accordingly, the petition for writ of certiorari should be granted.

Respectfully submitted,

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

HOWARD BERSCH,	:	
		71 Civ.5373
Plaintiff,	:	(RLC)
-against-	:	
DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL & CO., LIMITED, GUINNESS MAHON & CO., LIMITED, PIERSON, HELDRING & PIERSON, SMITH, BARNEY & CO. INCORPORATED, J. H. CRANG & CO., INVESTORS OVERSEAS BANK LIMITED, ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,	:	
Defendants.	:	

FILED WITH THE CLERK OF THE COURT
DECEMBER 4, 1974

Opinion of Carter, D.J. re Motions to Dismiss

CARTER, District Judge:

Posture of the Litigation

The instant action involves yet another chapter in the fitful recent history of I. O. S., Ltd., the once high-flying mutual fund management corporation. Plaintiff sues on behalf of all who purchased I. O. S. stock from participating underwriters in a September, 1969, tripartite offering, and alleges, in substance, that the prospectuses pursuant to which the offering was made were false and misleading in that they failed to reveal material facts concerning I. O. S.'s finances, illegal activities, chaotic bookkeeping, and mismanagement, and the actual looting and plundering of I. O. S.'s treasury, all in violation of Sections 12, 15 and 17 of the Securities Act of 1933 (15 U. S. C. §§77(l), 77(o), and 77(q)); Sections 10(b), 15(c)(1), and 20 of the Securities Exchange Act of 1934 (15 U. S. C. §§78j(b), 78o, and 78t), and SEC Rules 10b-5 and 15c1-2 (17 C. F. R. 240.10b-5, 240.15c1-2).

I. O. S. has been named a defendant, as has Bernard Cornfeld, who during the years with which this litigation is concerned was I. O. S.'s chief executive officer, board chairman, and largest shareholder. Other defendants include the eight principal underwriters and the international accounting firm which certified the financial statements that appeared in the prospectus.[1]

1. Six of the defendant underwriters headed one branch of the offering, and are at times hereafter collectively referred to as the "Drexel Group." They are Drexel Firestone, Inc. (formerly known as Drexel Harriman Ripley; since March 16, 1973, known as Lexerd & Co.; hereafter referred to as Drexel); Banque Rothschild (Rothschild); Hill Samuel & Co., Ltd. (Hill Samuel); Guinness Mahon & Co., Ltd. (Guinness Mahon); Pierson, Heldring & Pierson (Pierson Heldring); and Smith, Barney & Co., Inc. (Smith Barney), J. H. Crang & Co. (now known as J. H. Holdings, Ltd.; hereinafter referred to as Crang) was lead underwriter for a second branch of the offering, and Investors Overseas Bank, Ltd. (I. O. B.), headed up the third. The accounting firm is Arthur Andersen & Co. (Arthur Andersen).

In a memorandum opinion dated June 28, 1972, the court (Frankel, J.), ruled tentatively that this action might be maintained as a class action. In so doing, Judge Frankel expressly reserved for later determination by the Judge to whom the case was to be assigned for all purposes under the then-incipient individual assignment system, three issues: subject matter and personal jurisdiction; whether foreign purchasers should be included in the plaintiff class; whether and how the court's ultimate judgment may be made binding upon foreign class members. On December 27, 1972, the Drexel Group entered into a consent order (Ryan, J.) with the plaintiff, in which it was agreed that plaintiff would initially limit discovery to the issues left open by Judge Frankel, at the completion of which defendants would make jurisdictional and class determination motions within sixty days.

On April 2, 1973, Judge Ryan ordered that plaintiff's discovery be completed by September 1, 1973. On October 31 and November 1, 1973, defendants other than I. O. S. and Cornfeld filed motions designed to challenge the court's jurisdiction. On December 3, 1973, with the consent of the parties, Judge Ryan adjourned the motions to on or after April 15, 1974. Further adjournments followed.

During the same general period, defendants I. O. S. and Cornfeld were drawn into the fray. On December 7, 1972, a certificate of mailing was filed, indicating that a summons and complaint had been mailed to I. O. S. at an address in London, England. On May 21, 1973, a marshal's return was filed, indicating that Bernard Cornfeld had been served on May 15, 1973 at an address in California. Neither I. O. S. nor Cornfeld appeared, and on September 20, 1973, a default judgment was signed by Judge Ryan and entered against them. On December 5, 1973, defendant Cornfeld moved by order to show cause to vacate the default, and on December 26, 1973, Judge Ryan signed a consent order vacating the default and default judgment, and directing I. O. S. and Cornfeld to serve whatever jurisdictional motions they felt appropriate within forty days, said motions

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to be returnable at the same time as the aforementioned motions of the other defendants.

On February 1, 1974, a certificate of mailing was filed, indicating that a summons and complaint had been sent to I. O. S. offices in New Brunswick, Canada and Geneva, Switzerland, and to Cornfeld c/o St. Antoine Prison in Geneva, where he was then incarcerated. On February 21, Cornfeld filed a motion to dismiss the complaint and to amend Judge Frankel's class action determination, and on April 18, I. O. S. moved to dismiss the proceedings or, failing that, to stay them.

In mid-June, 1974, my chambers was informed that plaintiff and the Drexel Group were near agreement on a settlement, and that papers embodying the proposed settlement would be placed before the court by the end of June, at which time a conference would be requested. On June 28, 1974, a conference was indeed held. After a spirited exchange between the plaintiff and the "settling defendants" on the one hand and the "non-settling defendants" on the other, a second conference was set for July 15, at which time the relationship between the partial settlement and the pending motions was to be discussed. On the 15th, the parties were apprised of and apparently acquiesced in the court's proposal that it first determine whether subject matter jurisdiction was present, advise the parties orally of its decision so that a notice of settlement could be perfected and distributed, and thereafter the court would file a written opinion explaining its holding.

On July 29, the parties were notified by telephone that the court had concluded that it had subject matter jurisdiction and were given until July 31 to submit technical and procedural modifications to the proposed notice of settlement, and until August 2 to register responses to the suggested changes. On July 30, counsel for Crang requested another conference with the court and the parties. On July 31 that requested conference was held. The non-settling defendants urged the court to certify to the Court of Appeals, pursuant to 28 U. S. C. §1292, the subject matter

jurisdiction question. Further, they asked a stay of issuance of the notice of settlement until all appeals in respect of the jurisdictional questions had been exhausted. In addition, the non-settling defendants highlighted what they considered to be the most glaring defects in the proposed notice. I advised all present that inasmuch as similar facts and principles would be reviewed and applied in determining questions of subject matter *and* personal jurisdiction, I thought it appropriate to decide these issues together, and then assure appellate review of the package, either by directing the entry of a final judgment under Rule 54(b), Fed. R. Civ. P., or by certifying the jurisdictional questions to the Court of Appeals. I made it clear, however, that determination of the fairness of the settlement and approval or disapproval of same need not and ought not await the outcome of such appeals. I thereupon directed the parties to resolve among themselves as many of the suggested modifications to the proposed settlement as they could, and to submit for my determination the remainder. Moreover, approval of the settlement proposal was deliberately delayed to make certain that the time lag between that event and the filing of this opinion on the issues of subject matter and *in personam* jurisdiction would not be of long duration.

The Issues to Be Considered

Ripe for decision are defendants' motions to dismiss for lack of subject matter jurisdiction, for lack of personal jurisdiction, because of *forum non conveniens,* and (as to defendants I. O. S. and Cornfeld) because of defective service of process and because of plaintiff's failure to prosecute.

The Nature of the Offering

The 1969 I. O. S. public offering can be viewed as a single offering, two offerings, or three depending upon whether one focuses on the purposes of the offering and

the interaction of its prime movers, upon the character of the offerings themselves, or upon the structure of the selling arrangement and the identity and locus of the purchasers. The Drexel Group served as chief underwriters for a primary offering of 5,600,000 new shares sold in Europe to Europeans. I. O. B., a wholly-owned subsidiary of I. O. S., managed a secondary offering in which 490 I. O. S. shareholders, most of them American, sold 3,950,000 shares to I. O. S. employees, long-time clients, and persons with long-standing business relationships with I. O. S., approximately 386 of whom were Americans. Crang managed a secondary offering of 1,450,000 shares, 150,000 of which it received from I. O. B. None of these shares were sold to Americans.

Based upon the evidence before me at the present time, I am convinced that the three offerings were sufficiently integrated and intertwined so as to appropriately be considered a unified transaction for purposes of subject matter jurisdiction considerations. Although the defendants appear to have gone to great pains to refer publicly to the offerings as separate and distinct—and in fact each offering had unique characteristics and some non-identical parties—nonetheless they were closely tied components of a functionally integrated process. Each of the offerings was of common shares of I. O. S. Deposition testimony of key figures involved in the offerings, a memoranda circulated among the various defendants, and the three final prospectuses all confirm that the Drexel Group, I. O. B., and Crang branches of the offering were commenced simultaneously and at the same price of $10 (U. S.) per share. The closings of all of the offerings occurred simultaneously as well. Although three different prospectuses were utilized, those of the Drexel Group and I. O. B. were substantially identical. The Crang prospectus, while "different" from the other two insofar as it sought compliance with Canadian securities regulations, utilized the same certified financial statement prepared by Arthur Andersen & Co., as did the other two prospectuses.

The "Plan of Distribution," at page 29 of the Crang prospectus, describes a patent connection between the I. O. B. and Crang offerings. I. O. B., acting as agent for selling shareholders, most of whom were American, was to offer 4,100,000 shares of I. O. S. common. Of that amount, it agreed to sell 150,000 shares to Crang, which Crang would sell for the American shareholders along with the other shares it was offering. In effect, Crang had assumed the obligations of and rights to a portion of the I. O. B. offering.

Contemporaneous documents also reflect that the underwriters considered the offerings to be closely intertwined, if not unitary. Murray J. Howe, of Crang, described the proposed Canadian offering in an interoffice memo dated August 29, 1969, stating:

> "The *offering of common shares of I. O. S., Ltd.* to the public will total approximately $120,000,000 which will represent 20% of the total number of shares outstanding of the company. This new issue will be offered in Canada, the United Kingdom, Europe and other countries. The portion that will be offered in Canada (all Provinces) for Canadian distribution only, will approximate $15,000,000. . . . The Canadian, United Kingdom and European *offerings will all be co-ordinated* to be offered on or about September 24th. The issue price which will not be set until 3 or 4 days before the official offering date, will be between $10 and $11 per share which, incidentally, works out to be approximately 15 times current earnings." (See Appendix II, accompanying plaintiff's memorandum (hereinafter "Appendix II") Document 71.) (Emphasis added)

In a letter from Howe of Crang to Edward Cowett of I. O. S., discussing the upcoming offering and Crang's role as managing underwriter for Canada, reference was made to the need for someone to coordinate the various underwritings and for one underwriting agreement between

I. O. S. and the managing underwriters of each offering. (See Appendix II—Document 73).

As the offering took shape, the managing underwriters appear to have been acutely aware of their ties to each other's segment of the transaction. Grayson Murphy of Shearman & Sterling, the firm representing Drexel Harriman, in a letter to the SEC, dated May 14, 1969, requested a meeting with the Commission regarding the offering, seemingly, treating it as a unitary one. (Appendix II—Document 75). At the meeting, as described by a member of Drexel Harriman, Murphy explained the principal features of all three of the offerings. (Appendix II—Document 15a). In a letter to the SEC dated August 7, 1969, Murphy referred to the three offerings as separate, yet recognized the connections between the offerings in his attempt to obtain a favorable SEC opinion on registration of the shares. He was necessarily aware of the terms of the two other offerings and their effect upon his branch of the transaction. Moreover, in a reply letter to Murphy of September 8, 1969, the SEC saw fit to communicate information regarding "that part of the offering managed by Investors Overseas Bank."

The so-called "pertinent facts" stressed in Crang's reply memorandum in support of the motion to dismiss are inconclusive. The fact that the managing underwriters did not share in each other's fees might go to their particular roles and responsibilities in the offering, but has little bearing on the integrated nature of the transaction. Additionally, the alleged lack of activity by Crang in the United States and its failure to sell to United States citizens are potentially relevant to the issue of personal jurisdiction, but do little to elucidate the overall character of the offering and the relationship of its three branches.

While plaintiff is necessarily speculating, there appears to be substantial logic in his assertion that the primary and secondary features of the offering were necessary concomitants. The latter, which is an opportunity for management to realize on their investment, provides the incentive

for the primary offering. The primary offering managed by Drexel creates the market for management to realize its profit in the secondary offering managed by Crang and I. O. S. While this relatedness of purpose is difficult to document, sufficient ties have been demonstrated to support plaintiff's contention that the three offerings were so integrated as to have their prime movers collectively considered for purposes of subject matter jurisdiction.[2]

I

Defendants have moved, pursuant to Rule 12(b) (1), F. R. Civ. P., to dismiss for lack of subject matter jurisdiction.

The court's jurisdiction emanates primarily from §27 of the Securities Exchange Act of 1934, 15 U. S. C. §78aa.[3] To the extent that some of plaintiff's claims arise under the Securities Act of 1933, its jurisdictional provision—

2. Supportive of the integrated offering thesis which allows for collective consideration of the defendants, is the aider and abettor concept. Borrowed from the criminal law and the law of torts, it has been applied in private actions under the American securities laws. *See, e.g., SEC v. National Bankers Life Insurance Co.*, 324 F. Supp. 189 (N.D. Tex 1971); *Pettit* v. *American Stock Exchange*, 217 F. Supp. 21 (S. D. N. Y. 1963).

3. That provision reads, in pertinent part:

> *"Jurisdiction of offenses and suits.*
>
> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. * * *"

Section 22, 15 U. S. C. §77v—should be viewed as being coextensive in reach with that of the 1934 Act. This conclusion is dictated by the language of each statute as well as by the statutes' shared function in policing securities transactions that are effected within the United States or that have a significant domestic impact. *Cf. Leasco Data Processing Corp. v. Maxwell*, 468 F. 2d 1326, 1335-36 (2d Cir. 1972); *SEC v. United Financial Group, Inc.*, 474 F. 2d 354, 356 (9th Cir. 1973). At issue is whether the reach of those provisions extends to a securities transaction with substantial foreign components.

It is clear that the provisions of the American securities laws may cover transactions in the securities of foreign issuers. *See, Leasco Data Processing Corp. v. Maxwell, supra; Madonick v. Denison Mines Ltd.*, CCH SEC. L. REP. ¶94,550 (S. D. N. Y. 1974); *United States v. Clark*, 359 F. Supp. 131 (S. D. N. Y. 1973). Ultimately, the concern is that domestic law be applied only to transactions with which the United States has a significant connection or interest. In assessing a particular transaction's connection with the United States, two basic principles are applied, concurrently or alternatively.

The first approach, sometimes referred to as the "subjective territorial principle," extends jurisdiction over acts or omissions which occur within a state's boundaries, even though the effect of such acts or omissions may be felt without. This Circuit, in its most recent pronouncement on application of the securities laws to foreign securities, relied upon this principle as set forth in §17 of the Restatement (Second) of Foreign Relations Law of the United States (1965).[4] *Leasco Data Processing Corp. v. Maxwell, supra.*

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4. "§17. Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or Other Interest within Territory

A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and

(b) relating to a thing located, or a status or other interest localized, in its territory."

In *Leasco,* an American company sought damages resulting from the fraudulent sale of a British company, the stock of which was listed on the London Stock Exchange, but not on any American exchange. The actual purchase of the securities occurred in England. The court focused on misrepresentations and meetings which occurred in the United States, although it acknowledged that the crucial misrepresentations may have occurred in England. It stated, at 468 F. 2d 1334, that:

> "Conduct within the territory alone would seem sufficient from the standpoint of *jurisdiction,* to prescribe a rule. It follows that when, as here, there has been significant conduct within the territory, a statute cannot properly be held inapplicable simply on the ground that, absent the clearest language, Congress will not be assumed to have meant to go beyond the limits recognized by foreign relations laws."

The second approach, which has been labeled the "objective territorial principle," was implicitly applied in *Schoenbaum v. Firstbrook,* 405 F. 2d 215 (2d Cir. 1968). The principle, as set forth and illustrated in §18 of the Restatement (Second) of Foreign Relations Law of the United States (1965),[5] extends jurisdiction to conduct which

5. "§18. Jurisdiction to Prescribe with Respect to Effect within Territory

A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either

(a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

(b) (i) the conduct and its effect are constituent elements of activity to which the rule applies;

(ii) the effect within the territory is substantial;

(iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and

(iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems."

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occurs outside a territory, but which has an impact within the territory.[6]

In *Schoenbaum,* American shareholders brought an action against a Canadian company which did no business in the United States for fraudulent acts committed outside the United States with respect to the securities of that foreign company. The court found jurisdiction because the securities were registered on an American exchange and the transactions in question were seen as being detrimental to the interests of American investors. It cited two examples of transactions possessing foreign elements but having a domestic impact.[7]

> "We believe that Congress intended the Exchange Act to have extraterritorial application in order to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities."
>
> *Schoenbaum v. Firstbrook, supra,* at 206.

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6. An early application of this principle by this Circuit occurred in the well-known antitrust case of *United States v. Aluminum Co. of America,* 148 F. 2d 416 (2d Cir. 1945), where it was held at 443, that:

> "* * * it is settled law * * * that any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize * * *"

7. These two examples do not comprise an exhaustive list of transactions to which the objective territorial principle applies. *See, Travis v. Anthes Imperial Ltd.,* 473 F. 2d 515, 523, n.14 (8th Cir. 1973):

> "We are not persuaded that the Second Circuit intended, in *Schoenbaum,* to set forth the exclusive circumstances in which extraterritorial application of the Act is proper * * *. The court was not required to decide whether the Act would apply to a foreign transaction in foreign securities which had never been registered or listed on an American exchange when a number of significant elements of the fraudulent scheme took place in the United States.
>
> "Moreover, *Schoenbaum* was not a limiting decision as the Court decided that subject matter jurisdiction was present."

II

Application of the principles espoused in *Leasco* and *Schoenbaum* satisfies the court, as more fully explained below, that subject matter jurisdiction exists.[8]

The record indicates that conduct took place in the United States continually throughout the entire period during which the offering was conceived, assembled and effected. The offering was discussed and at least partially initiated and organized here during numerous meetings between the major underwriters, their American attorneys, I. O. S. officials and accountants. In March and April of 1969, an I. O. S. official met with a representative of Guinness Mahon Representation Co. of N. Y. (which was affiliated with Guinness Mahon & Co. Ltd. of London), and an officer of Drexel at Drexel's New York offices on two occa-

8. Plaintiff has relied upon a third theory of jurisdiction which this court need not explore in depth. Termed the "nationality principle," it carries less weight than the two approaches already described, and provides a territory with jurisdiction over the conduct, wherever effectuated, of its nationals. It provides, as embodied in §30 of the Restatement (Second), United States Foreign Relations Law, that:

> "§30. Jurisdiction to Prescribe with Respect to Nationals
>
> (1) A state has jurisdiction to prescribe a rule of law
>
> (a) attaching legal consequences to conduct of a national of the state wherever the conduct occurs or
>
> (b) as to the status of a national or as to an interest of a national, wherever the thing or other subject-matter to which the interest relates is located."

The American nationality and character of defendants was stressed in *SEC v. United Financial Group, Inc., supra.*

This theory of jurisdiction is relevant insofar as Drexel Harriman and Smith, Barney, the two leading underwriters of the primary offering, were American firms. In addition, Price Waterhouse was retained by Drexel Harriman as a consultant and to aid in the due diligence report. Finally, several New York law firms were involved in the preparation of the prospectus and the offering. Although I. O. S. was a foreign-based corporation, its president, Bernard Cornfeld, its chief operating officers, and many of its employees were Americans.

sions, during which the proposed offering was discussed. (*See* Appendix II—Documents 1 and 2).

After Drexel retained the New York law firm of Shearman & Sterling to represent it in the offering, members of that firm engaged in numerous meetings and interactions in and from the United States while shaping Drexel's participation and putting the offering together. Murphy, of Shearman & Sterling, met with Edward Cowett, an executive officer of I. O. S., and two representatives of Drexel in New York in order to discuss, *inter alia,* the listing of the shares, locations of the offering, and tax problems of I. O. S. officials. Murphy engaged in several telephone conversations from New York with Cowett in Geneva. (*See* Appendix II—Document 6). Drexel officials and its counsel met with SEC officials to discuss the offering and problems the SEC had with I. O. S. (*See* Appendix II—Document 8). Other communication with the SEC followed and Murphy was put on warning as to potential application of a 1967 SEC prohibitory order to I. O. B. sales to Americans. (Appendix II—Document 44).

Drexel retained the services of Price Waterhouse in New York to act as a financial consultant in the offering and to help investigate I. O. S. These efforts were part of the due diligence report. (Appendix II—Documents 11 and 13). Numerous planning and exploratory communications took place in New York, involving the underwriters, attorneys and Price Waterhouse. (Appendix II—Documents 15—20, 23). A review of some of the Arthur Andersen work papers involved in its earlier financial report on I. O. S. was made by Price Waterhouse officials in New York. While the bulk of those papers related to mutual funds owned by I. O. S., the information was relevant to preparation of the prospectus. (Appendix II—Document 20).

Negotiations and meetings between the principal parties continued through July and August of 1969 in New York and elsewhere. Although much of the work performed at that time was preliminary research undertaken by Drexel

prior to firmly committing itself, substantial elements of the offering were structured as a result of this activity. (See generally Appendix II—Documents 22—42). For example, at a meeting in which Cowett of I. O. S. and Coleman of Drexel expressed their intention to enter a firm agreement, terms of the offering were discussed—mainly prices and accounting procedures. Preliminary discussions on underwriting discounts and commissions possibly took place in New York. (Appendix II—Document 26). Financial information on I. O. S. and the various mutual funds it advised was sent to Price Waterhouse in New York and was kept on file there. (Appendix II—Document 28).

At a meeting in New York on July 11, 1969, members of Price Waterhouse, Arthur Andersen, Shearman & Sterling, I. O. S., and Drexel discussed the need for an audit or partial audit in connection with the offering planned for September. A timetable for the audit and the need for an early offering were discussed. Additionally, Arthur Andersen's work in connection with June 30, 1969 financials of I. O. S. was mentioned. (Appendix II—Documents 30, 32). Counsel for Drexel met with I. O. S. counsel in New York and discussed a draft of the opinion letter to be issued in connection with the offering. (Appendix II—Document 33).

After returning from work in Europe, Price Waterhouse officials met with members of Shearman & Sterling and Drexel in New York. They discussed a preliminary draft of a report by Price Waterhouse to Drexel that included questions about practices engaged in by I. O. S., and Arthur Andersen's financial report on the company. Work on that report was performed in Europe and New York. Price Waterhouse also reviewed property in Florida held by one of the funds managed by a subsidiary of I.O.S. (Appendix II—Documents 45 and 47).

On September 23, 1969, the day before the offering was to commence, an SEC investigation of a subsidiary of I. O. S. was reported in the press. Coleman of Drexel, Murphy of Shearman & Sterling, and Stammer of the law firm of Haft & Stammer met in New York and drafted a

sticker to be attached to the prospectus regarding the SEC investigation. Calls were made to I. O. S. officials in Geneva and a joint decision was made on the addition to the prospectus. (Appendix II—Document 50). Letters were sent by Murphy in New York to various participants in the offering, distributing a proof of the Closing Memorandum. (Appendix II—Document 52).

Drexel established bank accounts with the Bank of New York for the I. O. S. offering, and instructed those purchasing I. O. S. shares that payment was to be made in United States dollars to the Bank of New York on Broad Street, for the account of Drexel with the Bank of New York in London. (Appendix II—Documents 56—58). Meetings were held in New York and reports submitted on the progress of the offering. (Appendix II—Documents 63 and 64). A memorandum describing the procedure for the offering was prepared and distributed in New York. (Appendix II —Document 70).

During this period other underwriters had been contacted and were involved in the offering plan. In April of 1969, while in New York, Murray J. Howe, president of Crang, met with Cowett of I. O. S. While there is no indication that the meeting was pre-planned, the I. O. S. offering was discussed and Crang made an effort to secure the entire Canadian underwriting. (Appendix II—Documents 4 and 27). Howe's letter dated May 13, 1969, makes clear that details of the offering were discussed at the New York meeting. As demonstrated by the opening line of that letter —"When we last met in New York to discuss the forthcoming issue of I. O. S. Ltd. (S. A.) . . ."—the I. O. S. offering was not a peripheral topic of conversation, and was at least a primary reason for the meeting. (Appendix II—Document 73). A second meeting in New York occurred in July, 1969, at which the I. O. S. prospectus and offering were discussed. (Appendix III—Document 27).

Executives of Smith Barney, another leading underwriter, met in New York, discussed the offering and decided

to participate. (Appendix II—Document 12). They engaged in talks with Drexel in New York regarding the offering, and structured their own involvement in the offering. (Appendix II—Documents 36, 37, 39, 40, 42). Smith Barney determined that all of its I. O. S. share allocations would be made through its New York office (Appendix II —Document 49), and that payment for the shares was to be made to a bank in New York, payable to a sub-account in London. (Appendix II—Document 51).

In August and September of 1969, other prospective American underwriting firms were solicited. Those firms which did not have European offices were shown a draft of the prospectus which was brought from Europe and taken around by hand in New York. (Appendix II—Document 43).

Obviously, many of the documented occurrences, taken by themselves, are of minimal significance. Nonetheless, these circumstances viewed *in toto* disclose conduct constituting an essential link in the offering in the United States. While formal or ultimate acts were staged in Europe—e.g., the drafting of the final prospectus and signing of agreements—discussions, investigations, decision-making and planning were carried on, to a significant extent in the United States by Americans and others, and the acts abroad were substantially supervised from New York. Instrumentalities of interstate commerce were commonly used. Much of the effort that went into the due diligence report and preparation of the material basic to all the prospectuses also appears to have been expended in the United States.

III

Defendants place great emphasis upon the fact that fraudulent misrepresentations were not made or relied upon in the United States, thus distinguishing the transaction in question from the rule of *Leasco,* as they understand it. Their understanding is somewhat myopic insofar as

they treat synonymously the limited fact pattern in *Leasco* with the broader and more flexible legal principles which the court applied.

The crux of the jurisdictional basis in *Leasco* was the finding of "significant conduct within the territory." *Leasco Data Processing Corp.* v. *Maxwell, supra,* at 1334. *See also, Travis* v. *Anthes Imperial, Ltd.,* 473 F. 2d 515, 524 (8th Cir. 1973); *SEC* v. *United Financial Group, Inc., supra.* To be sure, in the instant case the ultimate representations or inducements do not appear to have occurred in the United States, as was true in *Leasco;* nevertheless, as just enumerated, other significant conduct clearly did occur here which influenced and shaped the entire underwriting and offering, including the extent and quality of disclosure. It would seem consistent with the *Leasco* approach to consider that conduct as jurisdictionally significant. As in *Leasco,* the mails and other instruments of interstate commerce were a necessary part of the domestic activity. Finally, the domestic conduct was, although less direct than that in *Leasco,* an "essential link" in inducing the ultimate purchases.

A second element integral to the finding of jurisdiction here is the impact which the transaction in question had upon American investors and the American securities market. The defendants acknowledge that the *Leasco* court considered significant the fact that an American company was defrauded. Fraudulent sale to Americans was also given weight by this court in *United States* v. *Clark,* 359 F. Supp. 131 (S. D. N. Y. 1973), and by the Ninth Circuit in *SEC* v. *United Financial Group, Inc., supra.* It is recognized that the defendants appear to have made an attempt to prevent any sales to Americans. Moreover, no sales to Americans did occur through the *Drexel* Group or Crang offerings. Nevertheless, as previously discussed, the three offerings should be considered a single transaction for purposes of subject matter jurisdiction. Sales through the I. O. B. offering have been documented to approximately

386 Americans, one among them being plaintiff Bersch. While this might ultimately prove to be a small number of the class sought to be represented, the number is not determinative.[9]

Plaintiff suggests another impact on the American securities market resulting from the offering. Plaintiff contends that I. O. S. was so deeply intertwined with the American securities market that its activities were an appropriate concern of the SEC and the courts under the mandate of our securities laws. I. O. S.' principal business activity at the time of the offering was the sale and management of mutual funds. Those funds conducted a massive amount of trading in American securities, giving them a significant potential to create severe market instability. As documented by Professor Morris Mendelson in a study of I. O. S., the findings of which are outlined in an affidavit submitted to the court, the failure of the I. O. S. offering had the effect of impairing foreign investor confidence in the American market and inhibiting sales of domestic securities abroad with a subsequent decrease in the flow of foreign capital; moreover, the mutual funds sold large amounts of American securities resulting in a depression in the prices of American securities. While proof of a clear correlation between the failure of the I. O. S. offering and the above-mentioned results is difficult to document, some credence must be given to the general proposition that a collapse of a public offering by a company whose subsidiaries trade and hold massive amounts of American securities would have a negative impact on the American market.

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9. In *SEC v. United Financial Group, Inc., supra,* only three American investors were ascertained. The court perceived a sufficient impact on American investors, holding at 356, 357:

> "In this case, focus should be upon appellants' activities within the United States and the impact of those activities upon American investors. Here, there was a showing of very substantial activities by appellants within the United States and a showing that, as a result of those activities, at least three American investors now hold nearly $10,000 worth of stock for which there appears to be no market * * *."

The Section 30(b) Exemption

Several of the defendants—Crang and Smith Barney—assert that they are exempt from the coverage of the Securities Exchange Act by reason of Section 30(b) of that Act, 15 U. S. C. §78dd(b). That section provides:

> "The provisions of this chapter or of any rule or regulation thereunder *shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States,* unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter." (Emphasis added)

The above-named defendants contend, in essence, that they transact a business in securities abroad.

In invoking §30(b), defendants have interpreted that provision literally, contrary to the prevailing view in this Circuit. Initially, it should be noted that in *Schoenbaum v. Firstbrook, supra,* it was held that §30(b) does not exempt those who engage in isolated foreign transactions. More significantly, the court explicitly held that "jurisdiction" as employed in §30(b) is not defined as "territorial limits." *Accord, SEC v. United Financial Group, Inc., supra.* If essential elements of the transaction in question occurred here, and/or there was a significant impact on the domestic market, then the transaction is deemed to have occurred within the jurisdiction of the United States and §30(b) does not apply. *See, e.g., Roth v. Fund of Funds, Ltd.,* 405 F. 2d 421 (2d Cir. 1968), *cert. denied,* 394 U. S. 975 (1969), *rehearing denied,* 395 U. S. 975 (1969); *In the Matter of I. O. S., Ltd.* (S. A.), CCH Fed. Sec. Rep. ¶78,637 (March 14, 1972).

Nor does *Kook v. Crang,* 182 F. Supp. 388 (S. D. N. Y. 1960), buttress defendants' argument. As the SEC noted

in its ruling in *In the Matter of I. O. S., Ltd. (S. A.), supra,* at 81,361:

> "*Kook v. Crang,* . . . makes clear that a Section 30(b) exemption depends upon a showing that all the essentials of the transactions in question occurred outside of the United States."

Here, concededly, certain essentials of the transaction did occur within the United States. That transaction involved the three intertwined offerings and therefore Crang and Smith Barney are all implicated in the jurisdictionally significant conduct which occurred domestically. Thus, each can be said to have transacted a business in securities *within* the jurisdiction of the United States, removing them from the protection of §30(b).

In Personam Jurisdiction

Two of the defendants—Crang and I. O. S.—[10] move for dismissal pursuant to Rule 12(b)(2), Fed. R. Civ. P., contending that this court lacks *in personam* jurisdiction as regards them. Their argument, as individually applied, is that they neither "do business" in the United States, nor committed acts here out of which the cause of action arose, nor engaged in conduct outside the United States which had significant, foreseeable effects within the United States.

While the principles applied in determining personal jurisdiction resemble in many respects those relevant to consideration of subject matter jurisdiction, they are not identical or co-extensive. Each is directed to the protection of different interests. In considering subject matter jurisdiction, it was the transaction that was the point of focus

10. The lack of *in personam* jurisdiction was also raised by the defendants who are parties to the proposed settlement as approved by the court. Since the issue of personal jurisdiction, in contrast to subject matter jurisdiction which was determined before the court approved the proposed settlement, was decided after the settlement was approved, that issue was not considered as to those who are parties to the proposed settlement.

and therefore the defendants could be viewed collectively as they were tied to the transaction. Personal jurisdiction, as the phrase itself connotes, requires that each party's connection with the forum be individually assessed.

The jurisdictional sections of the securities laws (Section 22(a) of the Securities Act and Section 27 of the Exchange Act) have been interpreted as extending their reach as far as the due process clause of the Fifth Amendment will allow. As was held in *Leasco Data Processing Corp. v. Maxwell, supra,* 468 F.2d at 1340:

> "... it is reasonable to infer that Congress meant to assert personal jurisdiction over foreigners not present in the United States to but, of course, not beyond the bounds permitted by the due process clause of the Fifth Amendment. ..."

It is apparent that neither of these defendants was "present" or "doing business" in the United States in the traditional sense, so as to establish personal jurisdiction. *See Hanson* v. *Denckla,* 357 U. S. 235 (1958); *International Shoe Co. v. Washington,* 326 U. S. 310 (1945). Crang was a Canadian brokerage house with no office, bank accounts, telephone listings, subsidiaries or affiliates in the United States. Nor did it have salesmen in the United States. I. O. S., at the time of the transaction in question, was a Canadian corporation with its principal place of business in Geneva, Switzerland. It did not maintain offices in the United States and was, in fact, restricted from engaging in securities transactions in the United States.[11] Neither of these corporations can be said to have engaged in systematic and continuous activity within the United States, invoking the benefits and protections of its laws. *Hanson v. Denckla, supra. See also, Restatement (Second) Conflict of Laws,* §47.

11. The question of whether I. O. S. could be considered to have been doing business in the United States by virtue of its subsidiaries or other entities, need not be reached in light of the disposition to follow.

Nevertheless, though not present or doing business in the United States, parties may come within the personal jurisdiction of this court. *See Restatement (Second) Conflict of Laws*, §§49 and 50. The Court in *Lcasco*, stated at 1340:

> ". . . where a defendant has acted within a state or sufficiently caused consequences there, he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state. . . ."

Even under the lesser standard of committing acts within the forum rather than engaging in systematic activity, Crang cannot be deemed to have satisfied *in personam* jurisdictional threshold requisites. The only acts of Crang within the United States related to the transaction in question appear to have been the breakfast meetings between Howe and Cowett. These *de minimis* preliminary discussions can hardly be considered acts out of which the cause of action arose. *cf. International Shoe, supra.* There has been no showing that they were related to the alleged misleading statements and omissions in the prospectuses. Moreover, plaintiff's purchase of I. O. S. shares does not appear to have been made in reliance on statements in the Crang prospectus, since that prospectus was sent to the United States after the date of purchase. The evidence reveals that Crang investigated I. O. S.'s affairs and prepared the prospectus in Canada, Switzerland and France. It accepted orders for I. O. S. stock in Toronto and sold shares only outside the United States and only to non-Americans.

As to I. O. S., the conclusion is different. The facts detailed earlier reveal that top I. O. S. officials were in the United States repeatedly during the planning of the offering, conferring with the lead underwriters and attorneys. Their meetings were directly related to the offerings, and information was discussed which later was incorporated into the prospectuses.

The second half of the jurisdictional test articulated by this Circuit in *Leasco*, namely—whether acts outside the United States sufficiently caused consequences here—remains to be applied to Crang. As defined by the Court, at 468 F. 2d 1341:

> "But this is a principle that must be applied with caution, particularly in an international context. . . . At minimum the conduct must meet the tests laid down in §18 of the Restatement (Second) of Foreign Relations Law, including the important requirement that the effect 'occurs as a direct and foreseeable result of the conduct outside the territory.' We believe, moreover, that attaining the rather low floor of foreseeability necessary to support a finding of tort liability is not enough to support *in personam* jurisdiction. The person sought to be charged must know, or have good reason to know, that his conduct will have effects in the state seeking to assert jurisdiction over him."

The conduct abroad of the individual party must have a substantial, direct, and foreseeable result in the United States.

In finding subject matter jurisdiction, it was significant that several hundred Americans purchased I. O. S. stock pursuant to the I. O. S. prospectus. Here, where Crang did not sell I. O. S. shares to any American citizen, took precautions to prevent and placed restrictions on the sales to Americans, and understood that all other parties to the offering would observe similar restrictions, it would be difficult to conclude that its conduct was designed to have an effect within the United States. Moreover, as noted in the section on subject matter jurisdiction, *supra*, the impact on the American securities market of the I. O. S. offering was in fact less than direct. The absence of clearly provable or probable negative domestic impact is close to fatal in the context of personal jurisdiction where impact *per se* is not the gravamen; rather the issue is whether there has

been impact *which a party had good reason to foresee.* Applying this more stringent standard, I cannot reasonably conclude that the conduct of Crang abroad justifies or permits the exercise by this court of personal jurisdiction over it.[12]

Plaintiff's remaining theory of jurisdiction, i.e., that individual defendants served as aiders and abettors, does not help create personal jurisdiction over Crang. As already indicated, Crang committed no acts within the United States which substantially fostered or made possible the allegedly fraudulent transaction. Moreover, acts within the United States of some conspirators do not confer jurisdiction over foreign co-conspirators. As held in *Leasco Data Processing Corp. v. Maxwell, supra,* at 1343, "The rule in this circuit is that the mere presence of one conspirator . . . does not confer personal jurisdiction over another alleged conspirator." *See, also, H. L. Moore Drug Exchange, Inc. v. Smith, Kline & French Laboratories,* 384 F. 2d 97, 98 (2d Cir. 1967); *Bertha Building Corp. v. National Theatres Corp.,* 248 F. 2d 833, 836 (2d Cir. 1957), *cert. denied,* 356 U. S. 936 (1958).

In conclusion, personal jurisdiction exists as to I. O. S., but is lacking as to Crang.

Remaining Contentions

Defendants Cornfeld and I. O. S. add a third string to their jurisdictional bow. They correctly observe that no matter how closely tied they or the 1969 offering are to the United States, this court may not exercise jurisdiction over

12. While jurisdiction over I. O. S. does rest on its acts within the United States, it is likely that such jurisdiction could be buttressed under the "effects" test. I. O. S., as the central figure in the transaction, had the most direct relationship to the information in the prospectus as well as the mechanics of the offering. It was also well aware of its ties to the United States securities market. Fraudulent sales to Americans, as well as the impact on the domestic market, were or should have been foreseeable results of its activities abroad.

them unless proper service of process has been made upon them. Section 22(a) of the Securities Act of 1933 (15 U. S. C. §77(a) and §27 of the Securities Exchange Act of 1934 (15 U. S. C. 78aa) expressly authorize extra-territorial service in any district "of which the defendant is an inhabitant or wherever the defendant may be found." However, they do not prescribe the *manner* in which service must be effected. Rule 4(i)(1)(D), F. R. Civ. P., is designed to fill such statutory gaps and provides for service "by any form of mail, requiring a signed receipt to be addressed and dispatched by the clerk of the court to the party to be served."

I. O. S. contends that it was not "found" at either the addresses where service was attempted. Plaintiff first sought to serve I. O. S. in 1972 by dispatching to I. O. S. at "99 Aldwych, London, W. C. 2, England" a copy of the summons and complaint, return receipt requested. The envelope containing the summons and complaint was returned to sender, and bore the handwritten word "Refused" and a series of markings which appear to be initials. In December of 1973, plaintiff consented to the vacation of a default judgment entered against I. O. S. three months earlier, without conceding that the original service of process had been invalid. Nevertheless, in February, 1974, plaintiff again attempted to serve I. O. S. by registered mail, this time dispatching a summons and complaint to 147 Rue de Lausanne, Geneva, Switzerland, and to 22 King Street, St. John, New Brunswick, Canada.

I. O. S. attacks the original service principally on the ground that I. O. S. did not at any time herein relevant maintain an office or otherwise transact business at the London address and accordingly could not be "found" there. Although plaintiff has at various times vouched (with decreasing ardor) for the process by which he obtained an address where I. O. S. could be served, and has urged this court to infer from the fact that *someone* in London refused service that it was *I. O. S.* who refused

service, plaintiff does not directly dispute that the London address was not I. O. S. territory.

The subsequent attempts at service are, however, less vulnerable to attack. I. O. S. concedes that the Geneva address was for years the site of its principal executive offices, but argues that in February, 1974, it could no longer be "found" there since five months earlier liquidation proceedings had been commenced in Canada, the country where it was headquartered and domiciled. To the extent that I. O. S. insists it could only be "found" at the place of business of its co-liquidators, it suggests too restrictive a standard of where a corporation may be found. *Cf., United States* v. *Scophony Corp.*, 333 U. S. 795 (1948). *See also, Wash-Virginia Ry* v. *Real Estate Trust,* 238 U. S. 185 (1914). To the extent that I. O. S. relies on its own representation that none of its employees remained at the Geneva address in February, 1974, a fact issue is raised. However, that question need not be resolved because the attempted service in New Brunswick, Canada, substantially satisfies the statute. Indeed, I. O. S. does not deny that the New Brunswick address was the "head office" of the company. Rather, it points to the fact that the complaint and summons sent to New Brunswick were returned to sender as proof that I. O. S. was not found at that address. But such a literal construction of "found" would mean that a defendant could avoid service of process merely by returning the summons.

I. O. S. further argues that even if it was "found" at one of the three addresses, none of the attempted services conformed to the procedural requirements of Rule 4(i)(2) which provides:

> "When service is made pursuant to [Rule 4(i)(1)(D)], proof of service shall include a receipt signed by the addressee or other evidence of delivery to the addressee satisfactory to the court."

Since the summons sent to New Brunswick was not accepted, it would be unreasonable to require as proof of

service a receipt signed by the addressee, and proof of service must be sought elsewhere. Upon examination of the postmarks and other official markings which appear on the returned envelope (Exhibit C of plaintiff's memorandum in opposition to the motion), the court is convinced that delivery was in fact made to the New Brunswick address. Finally, I. O. S. insists that service was defective because the return receipt required by Rule 4(i)(1)(D) was returnable to plaintiff's counsel rather than to the clerk of the court. However, the Rule only requires that the clerk attend to the mailing out of the notice. Here, the clerk did so, in response to a letter from plaintiff's counsel dated January 21, 1974.

Defendant Cornfeld's objection to service of process is more readily disposed of. He objects to the service in May, 1973, of a summons and complaint upon Ms. Diethild Gainer at a residence in Beverly Hills, California. However, the court need not speculate as to the relationship between Mr. Cornfeld and Ms. Gainer, or between either of them and the California abode, because in February, 1974, service was made pursuant to Rule (i)(1)(D) on defendant Cornfeld in St. Antoine Prison where he was indisputably "found."

Defendant I. O. S.'s final service of process argument is that the due process requirement set forth in *Mullane* v. *Central Hanover Bank & Trust Co.*, 339 U. S. 306, 314 (1950)—that "notice [must be] reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections"—is not here satisfied. However, the fact that defendant moved in 1973 to overturn the default entered against it manifests an awareness of the pendency of the action, and Judge Ryan's order of December 5, 1973, vacating that default provided defendant a fair opportunity to present its objections. Thus, by the time a technically correct service of process was effected in February, 1974, I. O. S. had actual notice of the proceeding

and was an active participant therein. Under all the circumstances, due process was satisfied.

Having thus determined that both subject matter and personal jurisdiction lie, the court must decide whether it should in the exercise of its discretion decline to exercise its jurisdiction. The motions made by certain of the defendants for dismissal on grounds of comity or *forum non conveniens*, and I. O. S.'s motion for a stay of proceedings are not well taken. However, more troubling are the motions made by defendants I. O. S. and Cornfeld to dismiss for failure to prosecute.

Plaintiff has not deigned to explain to the court why a year passed between its filing of the complaint and its first attempt to serve the moving defendants. Plaintiff's contention that it delayed issuing summonses until it obtained a full description of I. O. S.'s and Cornfeld's contacts with the United States rings hollow when played against the background of early service on defendants like Crang and Banque Rothschild. A more ingenuous explanation might have enabled the court to determine whether plaintiff's lack of diligence in prosecuting this action as against the movants was excusable. However, the particular circumstances of this case lead me to conclude that plaintiff's lack of diligence was, irrespective of the reasons for it, moderate rather than grave. Unlike the plaintiff in *Link* v. *Wabash R. Co.*, 370 U. S. 626 (1962), the plaintiff here has not blocked or retarded the orderly and expeditious disposition of its own case. Although this action has in general proceeded at a reasonable pace, it is still at an early stage of development. Threshold questions of jurisdiction are just now being decided, and defendants I.O.S. and Cornfeld were brought into the case soon enough to play a substantial role in focussing the jurisdiction inquiry.

Even though plaintiff's delay in serving the movants may be characterized as "moderate neglect," the question remains whether defendants were prejudiced by the delay. *Messenger v. United States*, 231 F. 2d 328 (2d Cir. 1956).

Indeed, in every case where an alleged failure to prosecute arises out of a delay in serving one defendant even though other defendants have been served and diligently proceeded against, it would seem analytically sounder to assess the prejudice *vel non* suffered by the odd-defendant-out rather than to assess the degree of the plaintiff's "neglect" as to that defendant. Here, I am reasonably convinced that any "prejudice" suffered by defendants I.O.S. and Cornfeld has resulted from the passage of time rather than from the service delay. Even had I.O.S. been served the same day the action was commenced, its ability to defend itself would have been affected by changes in personnel and control. There is no reason to believe that had these two defendants been served sooner this complex multiparty litigation would have proceeded more quickly or fairly. Up to this point, discovery has been limited to jurisdictional questions; and the movants have had ample opportunity (and taken advantage of same) to test out the court's jurisdiction. Accordingly, the motions to dismiss for failure to prosecute are denied.

CONCLUSION

The motions of all defendants to dismiss for lack of subject matter jurisdiction are denied. The motion of Crang to dismiss for lack of personal jurisdiction is granted, and the motion of I.O.S. to dismiss, for lack of personal jurisdiction is denied. The motions by I.O.S. and Cornfeld to dismiss because of defective service of process are denied, as are their motions alleging a failure to prosecute. The motions seeking dismissal on grounds of comity and *forum non conveniens* are denied as is I.O.S.'s motion for a stay of proceedings.

So Ordered.

Dated: New York, New York
November 26, 1974

/s/ Robert L. Carter

Robert L. Carter
U.S.D.J.

ON REQUEST FOR CERTIFICATION

The defendants have asked that the court's determination that it has subject matter jurisdiction and *in personam* jurisdiction over I.O.S. and Cornfeld filed this day be certified for appeal to the United States Court of Appeals pursuant to 28 U.S.C. §1292(b). The issue of subject matter jurisdiction clearly meets the statutory criteria. While the jurisdictional reach of our securities laws has been settled and clarified by our Court of Appeals in *Schoenbaum v. Firstbrook*, 405 F. 2d 215 (2d Cir. 1968) and *Leasco Data Processing Corp.* v. *Maxwell*, 468 F. 2d 1326 (2d Cir. 1972), there is substantial ground for difference of opinion as to whether the *ratio decidendi* of those cases was properly applied in the instant case. Moreover, the question of subject matter jurisdiction is a controlling issue of law in this case. If the court is in error, the whole controversy could be terminated. The basis for the court's determination was that the tripartite offerings involved were an integrated entity and not three distinct, separate and independent transactions. An immediate appeal, if the court is in error, will materially advance the ultimate determination of the controversy and "would save * * * the cost and delay of protracted and expensive litigation." *Bobolakis v. Campania Panamena Maritima San Gerassimo*, 168 F. Supp. 236, 240 (S.D.N.Y. 1958). Therefore, the request that the determination in respect of subject matter jurisdiction be certified for appeal pursuant to 28 U.S.C. §1292 (b) is granted.

The determination that *in personam* jurisdiction is lacking as to defendant Crang is made final and entry of final judgment is ordered entered pursuant to Rule 54(b), F. R. Civ. P.

However, I do not regard the conclusion that *in personam* jurisdiction exists in respect of I.O.S. and Cornfeld as meeting the requisites for certification. The standards for holding I.O.S. and Cornfeld personally subject to the court's jurisdiction are too well established and firmly fixed

for there to be much room for difference of opinion as to the conclusion reached by the court that personal jurisdiction over these defendants exists. The cases cited and relied on in the personal jurisdiction section of the opinion leave little basis for a contrary conclusion. Accordingly, the question is not certified for appeal.

Dated: New York, New York
November 26, 1974

/s/ Robert L. Carter

Robert L. Carter
U.S.D.J.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 783, 784, 795, 822—September Term, 1974.

(Argued March 6, 1975 Decided April 28, 1975.)

Docket Nos. 75-7038, 75-7055, 75-7057, 75-7031

HOWARD BERSCH,

Plaintiff-Appellee-Appellant,

v.

DREXEL FIRESTONE, INCORPORATED, DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL & COMPANY, LIMITED, GUINNESS MAHON & CO., LIMITED, PIERSON, HELDRING & PIERSON, SMITH BARNEY & CO., INCORPORATED, J. H. CRANG & CO., AND INVESTORS OVERSEAS BANK, LIMITED,

Defendants,

ARTHUR ANDERSEN & CO., I.O.S., LTD., and
BERNARD CORNFELD,

Defendants-Appellants,

J. H. CRANG & CO.,

Defendant-Appellee.

Before:

FRIENDLY, MULLIGAN and TIMBERS,

Circuit Judges.

Appeal pursuant to 28 U.S.C. § 1292(b) by three defendants from an order of the District Court for the Southern District of New York, Robert L. Carter, *Judge*, denying their motions to dismiss an action under the securities laws with respect to sales of stock of a Canadian corporation for lack of subject matter jurisdiction, and appeal by plaintiff pursuant to 28 U.S.C. § 1291 from another order dismissing the complaint against one defendant for lack of jurisdiction over the person. On the first appeal the order is affirmed in part and reversed in part and the cause remanded for further proceedings. On the second appeal the order is affirmed.

SIDNEY B. SILVERMAN, ESQ., New York, N.Y. (Silverman & Harnes, New York, N.Y., of Counsel), *for Howard Bersch, Plaintiff-Appellee-Appellant.*

EDWARD J. ROSS, ESQ., New York, N.Y. (James D. Zirin, Esq., and Breed, Abbott & Morgan, Esqs., New York, N.Y., and Charles W. Boand, Esq., and Wilson & McIlvaine, Esqs., Chicago, Ill., of Counsel), *for Defendant-Appellant Arthur Andersen & Co.*

BERNARD MINDICH, ESQ., New York, N.Y. (Michael W. Schwartz, Esq., and Wachtell, Lipton, Rosen & Katz, Esqs., of Counsel), *for Defendant-Appellant I.O.S., Ltd.*

LEONARD M. MARKS, ESQ., New York, N.Y. (Martin R. Gold, Esq., Charles B. Ortner, Esq., and Gold, Farrell & Marks, Esqs., of Counsel), *for Defendant-Appellant Bernard Cornfeld.*

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FRIENDLY, *Circuit Judge:*

These appeals from orders of Judge Carter in an action in the District Court for the Southern District of New York again bring before us the question of the territorial reach of the federal securities laws with which we have previously dealt in *Schoenbaum* v. *Firstbrook*, 405 F.2d 200 (2 Cir.), *rev'd on the merits*, 405 F.2d 215 (2 Cir. 1968) (*en banc*), *cert. denied sub nom.*, *Manley* v. *Schoenbaum*, 395 U.S. 906 (1969), and *Leasco Data Processing Equipment Corp.* v. *Maxwell*, 468 F.2d 1326 (2 Cir. 1972). Apart from differences in the facts, there is the added complexity that whereas *Schoenbaum* was a derivative action by stockholders of a Canadian corporation and *Leasco* an action by two corporate plaintiffs,[1] the suit here is a class action on behalf of thousands of plaintiffs[2] preponderantly citizens

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1 An American corporation and its wholly-owned British subsidiary.

2 The exact size of the plaintiff class has not yet been determined with any precision. In his original complaint, plaintiff Bersch, on the basis of an "estimate" that the average class member purchased 100 shares, alleged that there were approximately 100,000 potential class members. Apparently based on the alleged fact, revealed by discovery, that the average American purchaser bought 3,906 shares, and certain other information derived from the settling defendants, Bersch has now lowered his estimate of the size of the potential class to 25,000. On the record before us it is not possible to ascertain whether this new estimate is reasonable. On its face, if one were to assume that foreign purchasers on average subscribed for as many shares as discovery allegedly has revealed with respect to Americans, then even the 25,000 figure would be a significant overestimate. However, plaintiff's 3,906 average purchase estimate is based in part upon an erroneously high computation of the total number of shares allegedly purchased by

and residents of Canada, Australia, England, France, Germany, Switzerland, and many other countries in Europe, Asia, Africa, and South America.

I. *The Basic Facts.*

The securities transactions giving rise to this litigation go back to 1969. The securities were the common stock of defendant I.O.S., Ltd. (IOS), an international sales and financial service organization principally engaged in the sale and management of mutual funds and complementary financial activities organized under the laws of Canada,[3] having had its main business office in Geneva, Switzerland. It is now in the hands of liquidators appointed in November, 1973, by the Supreme Court of New Brunswick pursuant to the Canadian Winding-Up Act, Revised Statutes of Canada, 1970, ch. W-10.[4]

Americans. Elimination of an apparently inadvertent double counting error with respect to one major purchaser lowers the total shares purchased by the alleged 386 American purchasers from 1,507,578 to 844,683. Moreover, even after elimination of this error, the average purchase figure is still deceptively high since one of the American purchasers which plaintiff lists in support of his allegations—the IOS Foundation of Delaware—purchased some 662,895 shares. Exclusion of these shares from the averaging would reduce the average American purchase to around 200 shares, and extrapolation of this to the foreign purchasers would result in a class of some 50,000.

3 The mutual fund sales business which in 1960 was transferred to I.O.S., Ltd. (S.A.), a Panamanian Company, was founded by Bernard Cornfeld in Paris in 1956. By 1969, in addition to operating more than a dozen mutual fund sales companies throughout the world and a dozen mutual funds of its own, the Company owned ten banks and finance companies, a life insurance company with subsidiaries in six countries, a group of real estate companies, a couple of small publishing enterprises, and a data publishing firm.

4 The liquidation proceedings against IOS were initiated on August 30, 1973, before Mr. Justice Dickson of the Supreme Court of New Brunswick, Canada, on the petition of the Public Trustee of the Province of Ontario, as creditor of IOS. Subsequently two additional petitions for the liquidation of IOS were filed, one by another creditor, and one by

Prior to 1968 the stock of IOS and its subsidiaries had been held by its organizer, defendant Bernard Cornfeld, his associates, and their employees. Although Cornfeld had always been free to sell his IOS shares, and in fact had disposed of significant amounts of these over the prior nine year period, his employees had been denied the right to sell their holdings and no organized market for IOS shares existed. Within the company the price of the stock was set by a theoretical formula value; the stock was used as a means of partial compensation and was granted to employees as a performance incentive, it being commonly understood by the employees that the company would eventually be taken public and they might then "cash in".[5] A plan was developed wherein each of IOS's principal subsidiaries would first separately be taken public; finally common shares of IOS itself would be sold. In 1968 IOS floated 600,000 shares of one of its principal subsidiaries, IOS Management Ltd., a Canadian registered concern. The shares were offered at $12.50; trading opened at $75;

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a shareholder. See *In re I.O.S., Ltd.*, 7 N.B.R.(2d) 316 (S.Ct. 1973), *amended on appeal*, 7 N.B.R.(2d) 311 (S.Ct. App. Div. 1975). We are told that the filing of the first petition "followed and was in great measure the result of conferences among the governments of Canada and the Provinces of Quebec and Ontario, the regulatory authorities of Luxembourg and of the United States Securities and Exchange Commission." Affidavit of Herbert M. Wachtell, p. 4 n.*, April 16, 1974. During those conferences it was apparently agreed, *inter alia*, that liquidation of the various interconnected business entities that made up the multi-national IOS complex would be sought by or with the assistance of the relevant government or regulatory authorities of the corporate domiciles of the various key corporations. We are further told that it was agreed at the conference that an informal international committee made up of representatives of the various governments and regulatory authorities referred to above "would periodically meet and generally oversee the liquidation process." *Id.* at 3-4 n.*.

5 In 1967, in an apparent effort to sustain sales force loyalty and prevent further growth of dissatisfaction because the promised public market for IOS shares had not yet been created, the Company offered to buy back 10% of any employee's shareholding at the "formula price."

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and by March 1969 they had reached a peak of around $180. Subsequent to this sale, no doubt in part due to the success of this offering and more importantly to growing salesman dissatisfaction in light of a successful offering by a recently created competitor,[6] the decision was made to abandon the original plan and to take IOS public as soon as appeared feasible. The planning of this offering was constrained by the framework set out in an Order Accepting Offer of Settlement entered by the SEC on May 23, 1967. Paragraph 4 of this order provided in pertinent part:[7]

> Upon entry of the Order based on this Stipulation, IOS and all its affiliates shall cease all sales of

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6 Ten per cent of the outstanding shares of Gramco Management, Ltd., an offshore mutual fund sales management and investment company specializing in "liquid real estate", and a subsidiary of Gramco International which was founded in 1967, were offered in May, 1969 at $10 per share. At one point these shares apparently were trading at $20 but eighteen months later they were worth only about $2.

7 There is some internal contradiction between paragraph 4 of the Order which appears to permit sales to officers, directors and full-time personnel outside of the United States and paragraph 8 which begins "[s]ince IOS will, pursuant to the terms and conditions of this Stipulation, conduct all its securities activities outside the jurisdiction of the Commission and *limit all future sales to foreign nationals only . . .*" (emphasis supplied). Two letters to counsel for the Drexel underwriters in August and September of 1969, in response to earlier inquiries by them as to whether the Drexel group might obtain some form of no action letter from the SEC, did not greatly clarify matters. Although the August letter stated "that any sale of I.O.S., Ltd.'s stock to its employees who are nationals of the United States but residents abroad would be subject to the registration requirements of the Securities Act of 1933," letter from John Heneghan, Assistant Chief Counsel, to Grayson Murphy of Shearman & Sterling, August 21, 1969, the September letter, which purported to contain additional information, stated only that "in connection with the part of the offering managed by Investors Overseas Bank, if any of the 'larger holders of shares of investment companies managed by the company or its subsidiaries,' or any of the 'other persons having business relationships with the company or its subsidiaries,' are United States citizens or nationals, the prohibitions of the Commission's order of May 23, 1967 would be applicable to any offer or sale to such holders or persons." Letter of September 8, 1969.

> securities to United States citizens or nationals wherever located, except for (i) offers and sales outside of the United States (and its territories, possessions or commonwealth subject to the jurisdiction of the United States) to officers, directors and full-time personnel of IOS and its subsidiaries. . . .

Three separate distributions of IOS common stock were proposed. The largest was to be a primary offering of 5,600,000 newly issued shares underwritten by six of the defendants (hereafter the Drexel group)—two American banking houses, Drexel Firestone, Inc.[8] and Smith, Barney & Co., having their principal offices in the United States but also having offices in Europe, and four foreign underwriting houses, Banque Rothschild; Hill Samuel & Co. Limited; Guinness Mahon & Co. Limited; and Pierson Heldring & Pierson, having their principal offices abroad.[9] The 5,600,000 shares were to be and were in fact sold under a prospectus outside the United States to foreign nationals

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8 At the time of the underwriting the organization now known as Drexel Firestone, Inc. operated under the name Drexel Harriman, Ripley.

9 Defendants Banque Rothschild and Pierson Heldring and Pierson have submitted uncontradicted affidavits to the effect that they do not maintain any branch or office within the United States. Hill, Samuel & Co., Ltd. has submitted an affidavit to similar effect except that it admits to owning all the shares of Hill Samuel, Inc., a holding company which in turn owns all the shares of Hill Samuel Securities Corporation, a dealer in securities. Both of these companies maintain offices in New York City, as does an affiliated company, Lambert Hammond (U.S.A.) Inc., which is a general insurance broker. However, Hill, Samuel further states that none of these companies with offices in the United States were in any way connected with the IOS underwriting. Guinness Mahon & Co., Ltd. also submitted an affidavit stating that it has never maintained an office in the United States. Moreover, although admitting that one of its subsidiaries—Guinness Mahon Representation Co., Inc.—had maintained an office in New York City for a number of years, it stated that this subsidiary did not transact any business in the United States, served only as a "communications convenience", and is not authorized to accept service of process on Guinness, Mahon's behalf. Plaintiff

residing in Europe, Asia and Australia. Prospectuses were printed abroad in English, French, and German and delivered to the purchasers outside the United States. A secondary offering of 1,450,000 shares, underwritten by defendant J. H. Crang & Co., a Toronto investment house (Crang),[10] was made in Canada by a prospectus conforming to the laws of Canada and its provinces; all of these shares were sold in Canada and none was sold to Americans resident there.[11] The third distribution, whence this action springs, was a secondary offering of 3,950,000 shares by defendant Investors Overseas Bank Limited of Nassau, the Bahamas, an IOS subsidiary (IOB). The prospectus stated, as had that of the Drexel Group, that the shares "are not being offered in the United States of American or any of its territories or possessions or any area subject to its jurisdiction" and was "being made to approximately 25,000 persons who are either (1) employees or sales associates of the Company, (2) certain clients presently holding invest-

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nowhere contradicted these contentions by affidavit or other proof, although his brief contains an unsupported statement "that [d]efendant Guinness Mahon is also represented in the United States, with an office in New York City. Defendant Hill Samuel likewise has offices in this city."

10 The Successor organization to Crang is known as J.H. Holdings, Ltd.

11 One sale of 2,000 shares of IOS common was made to the Denver Office of Glore Forgan, Wm. R. Staats Inc. by Collier, Norris & Quinlan, a Canadian brokerage firm, for an unidentified customer. Clarke Ambrose, a Drexel officer, learned of the purchase when an employee of Glore Forgan contacted the Drexel Syndicate Department, inquiring as to whether Drexel might be able to aid him in obtaining an additional 8,000 shares to complete the customer's order. Recognizing the possible problems with the SEC that might arise from these transactions, Drexel contacted the president of Glore Forgan and the order was cancelled; moreover the customer was urged to break the transaction, although no information has been provided to us whether this latter effort was successful. The SEC was also informed of the substance of these transactions; the response of the official contacted essentially was that if this was indeed an isolated unintentional transaction no disciplinary action would be taken.

ments in managed funds or other products of the Company, or (3) persons who have had a long-standing professional or business relationship with the Company."

The offerings were made at the same price, $10 per share, and at approximately the same time. Each prospectus referred to the two other offerings. Reference was made to plans to list the IOS stock on various stock exchanges, none of these being in the United States. The Drexel Group and IOB prospectuses were substantially identical. Although the Crang prospectus was somewhat different insofar as compliance with particular Canadian securities regulations was sought, all three contained balance sheets of IOS and various subsidiaries as of December 31, 1968, and income statements for the five years then ended, and a report of defendant Arthur Andersen & Co. (Andersen), an international accounting firm with its principal office in the United States, that, subject to usual qualifications, the statements fairly presented the financial condition of the company as of December 31, 1968, and for the five years then ended. The Drexel and IOB prospectuses stated that the offerings had not been registered under United States securities laws.[12] The offerings were successful in the limited sense of being fully subscribed, but after stabilizing briefly at $14 the price of the shares drifted downward until April 1970 when it collapsed through the $10 level and three

12 In a release dated July 9, 1964, S.E.C. Release No. 33-4708 and No. 34-7366, 17 C.F.R. § 231.4708, 1 CCH Fed. Sec. Rep. ¶ 1362, the SEC stated that it:

> has traditionally taken the position that the registration requirements of Section 5 of the Act are primarily intended to protect American investors. Accordingly, the Commission has not taken any action for failure to register securities of United States corporations distributed abroad to foreign nationals, even though use of jurisdictional means may be involved in the offering. It is assumed in these situations that the distribution is to be effected in a manner which will result in the securities coming to rest abroad.

weeks later the shares apparently were virtually unsaleable. The plight of the purchasers was further aggravated when control of IOS passed into the hands of Robert L. Vesco, currently a resident of Costa Rica, and a defendant in a substantial number of actions for fraud pending in this circuit.

II. *The Proceedings in the District Court and this Court.*

The complaint in this action alleging violations of the Securities Act of 1933 and the Securities Exchange Act of 1934, and also containing allegations which can be read as charging common law fraud, was filed in December 1971 by Howard Bersch, a United States citizen living in New York, who had purchased 600 shares of IOS common distributed as part of the IOB underwriting.[13] Characterizing the three underwritings as the "IOS Public Offering", Bersch alleged he was bringing the action individually and on behalf of all persons who purchased stock in each of the offerings, estimated to approximate 100,000.[14] The complaint contained the allegations usual when a plaintiff desires designation of his action as a class action under Fed. R. Civ. P. 23(b)(3). It alleged that the underwriters "impliedly represented to the public that IOS was a suitable company for public ownership" when, in part as a result of the refusal of other investment houses to participate, they should have known that it was not. It also contained more particularized charges, e.g., that the prospectuses failed to reveal illegal activities by IOS and its officers which had seriously damaged the company,[15] that the books and

13 We shall deal in Section IV below with the circumstances of Bersch's purchase and the extent of purchases by other Americans.

14 See note 2 *supra*.

15 Any example of this alleged illegal activity was the participation by IOS officers in the smuggling of currency outside of developing

records of IOS and its subsidiaries and affiliates were in such a chaotic condition that it was impossible to determine from them an accurate picture of IOS' financial position, and that during the months preceding the offering various IOS officials, including Cornfeld, had touted IOS' prospects. It charged that the underwriters in the Drexel Group had failed to use due diligence with regard to their prospectus, and that Andersen had failed to observe generally accepted accounting principles in connection with its audit with the result that the financial statements were false and misleading in various respects unnecessary to detail here.

The first clash between the parties arose on a motion by plaintiff for class action determination. The defendants who had then been served[15] filed opposing affidavits and memoranda which raised the question of the propriety of the inclusion of foreign purchasers in the class but did not ask that the complaint be dismissed. On June 28, 1972 Judge Frankel ruled in a short memorandum. Recognizing that "[t]he submissions on this motion are substantial and interesting," he thought that the incomplete record before him precluded ultimate decision. Any attempt at this was even more undesirable because of the impending change in the Southern District's calendar plan whereby the case would be assigned for all purposes to a single judge, probably not himself. After this prelude, he announced the following conclusions:

> (1) It is not possible (or desirable) to say now with confidence whether the transactions plaintiff assails are reachable under either or both the 1933 and 1934

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countries in violation of their restrictive currency laws. As a result of this activity IOS had been barred from doing business in several of these countries.

16 No attempt was made to serve defendant Cornfeld until May 15, 1973. See note 61 *infra*.

Acts. Defendants obviously took pains to structure their activities to avoid the reach of American securities laws. Whether they succeeded is a question that will probably merit extensive discovery.... Whatever final decision may be reached on the applicability of the American securities laws, plaintiff has adduced enough to allow the case to proceed for the time being as a class action.

(2) Plaintiff has also made a case sufficient for present purposes that there are predominant common questions of law and fact justifying a class action under Rule 23(b)(3). . . . It is feasible to leave for later determination, upon a fuller record, the question whether foreign purchasers will be entitled to invoke the protections and sanctions of American securities laws. For the present at least, all purchasers may be represented as a single class by the evidently energetic, competent and motivated team of counsel for the named plaintiff.

(3) Defendants[']... question as to whether foreign investors, whatever actual or constructive notice they receive, will be bound in their own courts by an adverse decision in the instant class action [is serious].

(4) [In view of] the substantial change in the procedures of this court [each civil case is to be assigned for all purposes to the same judge] basic questions affecting the management of the case [such as] [t]he keystone . . . matter of notice under subdivision (c)(2) of Rule 23 . . . should be, and will be, left for the judge in charge of it.

The memorandum concluded:

The single question now resolved (and this, too, is of course open for reexamination under Rule 23(c)(1)) is

> as to the suitability of allowing the case to proceed as a class action. Plaintiff's motion in this respect is granted. The action may be maintained as a class action on behalf of all purchasers of IOS shares in the 'IOS Public Offering,' as detailed in the complaint, of 10,992,000 shares beginning in September 1969.[17]

On December 27, 1972, the Drexel Group entered into a consent order with plaintiff Bersch, in which it was agreed that plaintiff would initially limit his discovery to the issues that Judge Ryan considered to have been left open by Judge Frankel,[18] at the completion of which the defendants might make jurisdictional and class action motions within sixty days. After plaintiff had had extensive discovery, particularly directed at the extent of the activities of the defendants within the United States, the defendants, in the fall of 1973, moved to dismiss the complaint for lack of subject matter jurisdiction and, in some cases, lack of jurisdiction over the person; several of the motions also requested that Judge Frankel's class action determination be either vacated or modified to exclude foreign purchasers. While these motions were pending before Judge Carter, to whom the case had been assigned the members of the Drexel Group, on June 8, 1974, entered into a stipulation of settlement. As against the original claim of some

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17 Although this seems clear enough to us, apparently it has not been so to others. Judge Ryan, who ruled on the discovery motions, said in colloquy that Judge Frankel "didn't enter any class order. He defined no class. Therefore what he said was dictum." Appellant Andersen says in its brief that "[a]ppeal was not taken from Judge Frankel's order, since all defendants shared Judge Ryan's opinion that a class had not really been defined, and viewed Judge Frankel's decision as a mere holding action to enable the actual determination to be made by the judge to whom the case would be assigned for all purposes." Whether this view was justified or not, no one has urged that anything turns on the failure to attempt an appeal at that time.

18 See note 17 *supra*.

$110,000,000, plus interest from September, 1969, this provided for a payment of $700,000. The settlement was conditioned upon the entry of a final judgment approving it as regards the settling defendants; reserving all rights of plaintiff against non-settling defendants; and providing that the settling defendants should receive out of any recovery against the non-settling defendants the amount of any liability arising from cross-claims and their expenses in defending against these and in assisting in the prosecution of this action. It was conditioned also on the dismissal with prejudice and on the merits of any other action brought in any court arising out of any of the events described in the complaint. The settling defendants might withdraw from the settlement if members of the plaintiff class holding more than 300,000 IOS shares should opt out. On December 4, 1974, Judge Carter entered an order setting a hearing on the proposed settlement for March 21, 1975. The settling defendants were to mail notices of the hearing in a form annexed to the order[19] to each purchaser from them, were to request each underwriter or dealer known to have participated in any of the three underwritings to mail similar notice to purchasers from them and furnish an adequate number of copies and postage, and to cause notice to be published in The New York Times, the Paris Herald Tribune, the Montreal Gazette, and the Toronto Globe and Mail. The notice included an indication that plaintiff's counsel intended to apply for a fee in the amount of $200,000 and reimbursement of expenses then in the amount of some $10,000.

The district court had been kept advised of the progress toward settlement and there had been conferences concerning the relation between the settlement and the ruling on

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19 The notice was to be only in English.

the pending motions to dismiss. Pursuant to an agreement on procedure at a conference on July 15, 1974, the parties were notified by telephone on July 29 that the court had concluded it had subject matter jurisdiction and was preparing an opinion to that effect. At a further conference on July 31, the non-settling defendants requested that the court in its opinion certify the issue of subject matter jurisdiction for an interlocutory appeal under 28 U.S.C. § 1292(b).

The district court rendered its opinion on November 26, 1974. The first question it addressed was whether the 1969 IOS Public Offering fairly could be viewed as one, two, or three distinct offerings. Depending upon whether one focused "on the purposes of the offering and the interaction of its prime movers, upon the character of the offerings themselves, or upon the structure of the selling arrangement and the identity and locus of the purchasers," each of these views was considered at least arguable. The court concluded that the three offerings were sufficiently integrated that they should be considered as one for the purpose of determining subject matter jurisdiction. It then found subject matter jurisdiction because of three factors:

> (1) The amount of activity in the United States, almost entirely in connection with the Drexel offering, by the underwriters, their counsel and accountants (Price Waterhouse & Co.) and IOS.
>
> (2) Sales to Americans, estimated at 386 individuals, even though "the defendants appear to have made an attempt to prevent any sales to Americans" and none occurred through the Drexel Group or Crang offerings.
>
> (3) Generally adverse effects upon the American securities markets from the collapse in the price of the IOS shares offered.

The court rejected contentions of Crang and Smith Barney & Co. that they were exempt from liability under the 1934 Act by virtue of § 30(b).[20] Turning to *in personam* jurisdiction it sustained the contention of Crang that it was not subject to the jurisdiction of the district court but rejected that of IOS.[21] It likewise rejected contentions of IOS and Cornfeld with respect to the method of services of process, as well as of undue delay in effecting service.[22] It also denied an application of IOS for a stay of proceedings against it on the ground that comity required any claims to be determined in the New Brunswick liquidation. The court certified its ruling with respect to subject matter jurisdiction for an interlocutory appeal under 28 U.S.C. § 1292(b) and affixed a Rule 54(b) certificate to its order dismissing against Crang for lack of jurisdiction over the person. However, it declined to grant a § 1292(b) certificate with respect to its various unfavorable rulings as to IOS and Cornfeld which we have just described.

On December 17 Andersen and Cornfeld moved this court to stay the mailing and publication of the notice of the proposed settlement on the ground that the district court had no subject matter jurisdiction and that publicizing of the settlement would stir up litigation against them. We granted a stay on December 19 pending consideration of the motions for leave to appeal under § 1292(b) by

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20 Section 30(b) provides:

> (b) The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title.

21 The court did not pass on the *in personam* jurisdiction claims of some of the settling defendants. See note 9 *supra*.

22 See note 61 *infra*.

Andersen, IOS and Cornfeld, which were being held by the clerk to await opposing papers, and if such motions were granted, for such further period as should then be provided. Subsequently we granted the motions for leave to appeal under § 1292(b), consolidated the three appeals, set an expedited schedule, and extended the stay pending argument of the appeals and such further period, if any, as might then be determined.[23] Later we also consolidated plaintiff's appeal from the order dismissing the complaint against Crang for want of jurisdiction over the person.

III. *Subject Matter Jurisdiction in General.*

Appellants vigorously attack the district court's "integration" of the three offerings. They say that the SEC has employed this concept only to prevent evasion of rules exempting from registration offerings of a certain amount or less as in Regulation A, 17 C.F.R. § 230.254, or to no more than a specified number of purchasers, as in SEC Rule 144, 17 C.F.R. § 230.144, but not in a situation like that here presented. They argue that once the integration theory is rejected, there is no subject matter jurisdiction over purchasers in the Drexel offering, in which there was certain United States activity, since there were no American purchasers, no subject matter jurisdiction with respect even to the American purchasers in the IOB offering since defendants engaged in no activities in the United States with respect to that offering, and no subject matter jurisdiction as to the Crang offering since there were neither United States activities nor American purchasers. Plaintiff responds that all this is simply playing on the judge's use of the word "integration", and that what he meant and indeed said was that, for purposes of determining subject matter jurisdiction, the three offerings were sufficiently

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23 At argument we extended the stay pending decision.

intertwined that it is unrealistic to fractionate them. For reasons that will appear in the course of our discussion, we do not believe this point to be quite so vital as the parties do. We shall deal with it when its relevance appears.

A few preliminary observations will be helpful. We have no doubt that the activities within the United States, detailed in the judge's thorough factual findings,[24] were sufficient to authorize the United States to impose a rule with respect to consequences flowing from them wherever they might appear, under the principle stated in Restatement (2d) of the Foreign Relations Law of the United States § 17, "Jurisdiction to Prescribe with Respect to Conduct, Thing, Status, or Other Interest within Territory"

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24 The judge found, among other things, that representatives of IOS, the major underwriters in the Drexel Group, their attorneys and accountants met in New York on numerous occasions to initiate, organize and structure the offering; that a New York law firm was retained to represent the underwriters and had numerous meetings with IOS; that Drexel officials and counsel met with the SEC; that the underwriters retained Price Waterhouse & Co. in New York as accountants to assist in reviewing the operations of IOS and received reports from that firm there; that on one occasion Andersen representatives met in New York with the underwriters to explain why Andersen could not perform a full audit for the period January 1-June 30, 1969, within the time allotted and to discuss the amount of work that Andersen might be able to complete during that period; that preliminary discussions on underwriting discounts and commissions possibly took place in New York in July and August, 1969; that parts of the prospectus were drafted in New York and read over the telephone to Geneva; that prospective underwriters were shown a draft of the prospectus in New York; and that accounts for the proceeds of the underwriting were opened at the Bank of New York and the proceeds in dollars were to be deposited there pending remittance to IOS. Appellants do not seriously dispute these findings. Their contention is rather that the findings give a distorted picture since the work that was done in New York was mostly preliminary or ancillary to the work done in Europe, that the substantial bulk of the work was done in Europe, that all final action was taken there, and that there was no distribution of prospectuses or other promotional literature to purchasers within the United States—therefore that any fraudulent misrepresentations were neither made nor relied on in the United States.

(1965),[25] quite apart from the power of the United States to impose rules on the conduct of its own nationals, *id.* § 30, and see *Steele* v. *Bulova Watch Co., Inc.*, 344 U.S. 280, 282 (1952). But, as we said in *Leasco, supra*, 468 F.2d at 1334, "it would be . . . erroneous to assume that the legislature always means to go to the full extent permitted." When, as here, a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries.

The second observation is that, despite the vigorous but opposing contentions of the parties, neither *Schoenbaum* nor *Leasco* is decisive. It is true that the precise grounds on which jurisdiction was upheld in those cases are not present here. In *Schoenbaum* an issue of stock to insiders of a Canadian company in Canada, allegedly at an unfairly low price, adversely affected the value and the price of its shares listed on the American Stock Exchange, some of which were held by resident American citizens, including the plaintiff; in *Leasco* a series of alleged misrepresentations with respect to an English corporation were made in the United States to officers of a publicly held American

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25 A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory, and

(b) relating to a thing located, or a status or other interests localized, in its territory.

Moreover, as we noted in *Leasco, supra*, 468 F.2d at 1334, "[w]hile the black letter seems to require that . . . not only there should be conduct within the territory but also the conduct relate 'to a thing located, or a status or other interest located in its territory,' Comment A and Illustrations 1 and 2 . . . appear to be satisfied if there has been conduct within the territory." See *id.* n.3.

corporation that was being induced to purchase its stock even though other misrepresentations were made in England and the purchase of the shares of the English corporation was effected there. Plaintiff has not brought himself within the ambit of either case; moreover, neither *Schoenbaum* nor *Leasco* raised the serious problem here presented of the dubious binding effect of a defendants' judgment (or a possibly inadequate plaintiff's judgment) on absent foreign plaintiffs or the propriety of purporting to bind such plaintiffs by a settlement.[26] However, the absence of certain of the elements which led to finding subject matter jurisdiction in those cases does not necessarily preclude a similar conclusion on the different facts presented here. See *Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515, 523-24 n. 14 (8 Cir. 1973).

Thirdly, the SEC's disclaimer of the applicability of the registration requirements of the 1933 Act, see footnote 12 *supra*, to public offerings even of the securities of American corporations outside the United States, wherever the offerings may have originated, "so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within or to nationals of the United States," greatly emphasized by appellant Andersen, has only a peripheral bearing. While counsel for the underwriters could justifiably have relied on this policy statement in advising that registration was not here required,[27] they could not have relied on it to advise their clients that the latter were free to engage in

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26 Such problems are not presented when the SEC seeks to enjoin activity as in *SEC* v. *Gulf Intercontinental Finance Corp.*, 223 F. Supp. 987 (S.D. Fla. 1963), and *SEC* v. *United Financial Group, Inc.*, 474 F.2d 354 (9 Cir. 1973), on which plaintiff relies, or when the action is by named plaintiffs, as in *Leasco* or in *IIT* v. *Vencap, Ltd.*, this day decided.

27 Plaintiff does not seriously claim that it was required.

fraud, and there is, of course, no suggestion that they did.[28] It is elementary that the anti-fraud provisions of the federal securities laws apply to many transactions which are neither within the registration requirements nor on organized American markets. See *Leasco, supra,* 468 F.2d at 1335-37.

With this background we turn to the three elements a combination of which led the district judge to conclude that subject matter jurisdiction existed with respect not only to the relatively few Americans who had purchased IOS shares but to the many thousands of foreign purchasers whom plaintiff sought to represent. We think it will be useful to consider the first and third elements on which the court relied before we take up the second.

Assuming that there were no American purchasers and that the underwriting related, for example, to a large foreign industrial company clearly identified with a foreign country rather than with the United States, e.g., Rolls-Royce, Mercedes-Benz or Fiat, we do not believe the activities in the United States, see note 24 *supra,* would justify an American court in taking jurisdiction in a suit for damages by foreign plaintiffs. The fraud, if there was one, was committed by placing the allegedly false and misleading

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28 Although SEC officials reaffirmed the existence of the registration exemption for certain foreign offerings, see note 12 *supra,* the potential applicability of the anti-fraud provisions of the securities acts to the transactions here in question was specifically brought to the attention of counsel for the underwriters in a letter from the Secretary of the SEC at an early stage of the planning process:

> However, though Securities Act registration of such an offering [an underwriting of the type described in note 12 *supra*] is not required the anti-fraud provisions of the Securities Act and the Securities Exchange Act of 1934 would, in general, be applicable to the activities of a registered broker-dealer participating in such an underwriting.

Letter from Orval L. Dubois, Secretary, SEC, by Mellye A. Thorson, Ass't Secretary, to Grayson M. P. Murphy of Shearman & Sterling, June 6, 1969.

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prospectus in the purchasers' hands. Here the final prospectus emanated from a foreign source—London or Brussels in the case of the Drexel offering, Toronto in the case of the Crang offering, and apparently the Bahamas and Geneva in the case of the IOB offering. Not only do we not have the case where all the misrepresentations were communicated in the nation whose law is sought to be applied as in Illustration 2 of § 17 of the Restatement (2d) of Foreign Relations Law at 45, see *Leasco*, 468 F.2d at 1334 n.3, or the case where a substantial part of them were, as in *Leasco* itself, but we do not even have the oft-cited case of the shooting of a bullet across a state line where the state of the shooting as well as of the state of the hitting may have an interest in imposing its law. At most the acts in the United States helped to make the gun whence the bullet was fired from places abroad; alternatively proper action in the United States would have prevented the gun's ever being sent abroad. We are indeed holding in *IIT* v. *Vencap, Ltd.*, decided this day, that Congress did not mean the United States to be used as a base for fraudulent securities schemes even when the victims are foreigners, at least in the context of suits by the SEC or by named foreign plaintiffs. But as we there point out, that holding itself goes beyond any case yet decided,[29] and we see no reason to

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29 Apart from the fact that both cases cited in note 26 were injunction actions by the SEC, the court in *Gulf Intercontinental* relied in part on misrepresentations and offers contained in advertisements in newspapers that were distributed within the United States, some of which "no doubt" had been read by American investors in this country, 223 F. Supp. at 994-95, and in *United Financial* the court was dealing with a scheme master-minded by a United States issuer and based in the United States. While *Travis* v. *Anthes Imperial Ltd.*, *supra*, 473 F.2d 515, was a class action for damages, the plaintiff class was limited to American shareholders, 331 F. Supp. 797, 799, and the named plaintiffs alleged that they had been subjected to misrepresentations in the United States. Moreover, the court specifically reserved the question whether the action might proceed as a class action until after plaintiffs had

extend it to cases where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad. We thus conclude that the action and inaction which here occurred in the United States would not of itself confer subject matter jurisdiction with respect to foreign plaintiffs even if we assume *arguendo* that the three underwritings may be considered for this purpose as one.

We turn next to the third ground on which the district court predicated subject matter jurisdiction—the adverse general effect of the collapse of IOS in the United States. This was based on an affidavit by Morris Mendelson, Associate Professor of Finance at the Wharton School of the University of Pennsylvania. Professor Mendelson's principal conclusions were that:

> (1) The aftermath of the Drexel offering "was a debacle of monumental proportions which resulted in a deterioration of investor confidence in American underwriters at home and, particularly, abroad," and increased the problems of United States corporations in seeking to raise capital abroad.
>
> (2) "The false and misleading prospectus issued in connection with the Public Offering impaired investors' confidence and trust and contributed to a steep decline in the purchase of United States securities by foreigners" with attendant adverse effects on the balance

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completed discovery. *Finch* v. *Marathon Securities Corp.*, 316 F. Supp. 1345 (S.D.N.Y. 1970), and *Investment Properties Int'l, Ltd.* v. *I.O.S., Ltd.*, CCH Fed. Sec. L. Rep. [1970-1971 Transfer Binder] ¶ 93,001, *aff'd without opinion* (2 Cir. 1971) (unreported), both private damage suits, look in the other direction, as does the recent decision in *SEC* v. *Kasser*, D.N.J., Civ. Action No. 74-90, decided March 11, 1975 (Whipple, *Ch. J.*).

of payments and the price of American securities generally.

(3) Loss of investor confidence in IOS led to large redemption of shares in the mutual funds controlled by it, notably Fund of Funds Limited, which required the funds to sell substantial parts of their portfolios, mainly United States securities, with consequent depression of prices.

(4) Part of the attraction of American securities to foreigners has been the superior disclosures afforded by SEC registration requirements. The collapse of IOS after the offering undermined this confidence since IOS was "identified as an American company in the minds of investors", the Drexel underwriting was led by an American firm and the accountants, Andersen, were American.

(5) The collapse of IOS after the offering "contributed to a breakdown in the entire structure of building up an offshore investing industry whereby funds of European investors were channeled into American securities markets."

Although appellants attack certain of Professor Mendelson's conclusions as erroneous or exaggerated,[30] we do not doubt that the collapse of IOS after the offering had an unfortunate financial effect in the United States. Never-

30 Appellants particularly dispute whether there was any causal connection between the disinvestment by foreigners in United States securities and mutual funds and the collapse of IOS in April or May of 1970. They point out that there had been a steady long term decline in the prices of shares traded on the New York Stock Exchange, beginning in 1969—the Dow Jones Index reached 985 in 1968, fell to 746 by February 2, 1970, and reached 631 on May 26, 1970—which continued through most of 1970 but that the index began to rise in the latter half of 1970, reaching 794 on December 1.

theless we conclude that the generalized effects described by Professor Mendelson would not be sufficient to confer subject matter jurisdiction over a damage suit by a foreigner under the anti-fraud provisions of the securities laws.[31]

This branch of plaintiff's arguments goes back to Mr. Justice Holmes' statement in *Strassheim* v. *Daily*, 221 U.S. 280, 284-85 (1911), which was relied on by Judge L. Hand in *United States* v. *Aluminum Co. of America*, 148 F.2d 416, 443 (2 Cir. 1945),[32] and by Chief Judge Lumbard in *Schoenbaum, supra*, 405 F.2d at 206:

> Acts done outside a jurisdiction, but intended to produce and producing detrimental effects within it, justify a state in punishing the cause of the harm as if he had been present at the effect, if the state should succeed in getting him within its power.

See Restatement (2d) of Foreign Relations Law § 18, "Jurisdiction to Prescribe with Respect to Effect within Territory". The statement, however, must be read in context. The indictment at issue in *Strassheim* v. *Daily* charged that Daily, in Illinois, had connived with the warden of a Michigan prison to defraud the prison's Board of Control by substituting worn and second-hand machinery

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31 We therefore find it unnecessary to consider the contention of certain appellants that even assuming that the IOS collapse did have a substantial adverse effect on United States securities markets and the ability of American firms to obtain investment capital from foreign sources, the allegedly fraudulent underwriting occurred many months prior to the collapse and was wholly unrelated to it.

32 In effect this court was acting in lieu of the Supreme Court by virtue of a 1944 amendment to 15 U.S.C. § 29 (certification of appeal of Government civil antitrust action to court of appeals when no quorum of Justices in Supreme Court). See *United States* v. *Aluminum Co. of America*, 320 U.S. 708 (1943).

for the new machinery that had been ordered, and the Court declined to upset, on a petiton for habeas corpus, an order extraditing Daily from Illinois to Michigan. This principle would support subject matter jurisdiction if a defendant, even though acting solely abroad, had defrauded investors in the United States by mailing false prospectuses into this country, see ALI Proposed Federal Securities Code (Draft No. 3, April, 1974) § 1604(a)(1)(A) & Comment (3)(b) at 165-66, or if, as in *Schoenbaum*, the number of shares of a company traded on American exchanges was increased by a sale to insiders without adequate consideration at least when this is imperfectly disclosed, *cf. Popkin* v. *Bishop*, 464 F.2d 714 (2 Cir. 1972). But it does not support subject matter jurisdiction if there was no intention that the securities should be offered to anyone in the United States, simply because in the long run there was an adverse effect on this country's general economic interests or on American security prices. Moderation is all. This, we think, is what Judge Hand had in mind in the remarks in his *Aluminum* opinion quoted in the margin.[33] These considerations are particularly pertinent in view of the limitations in § 17(a) of the 1933 Act to acts in "the offer or sale of any securities" and in § 10(b) of the 1934 Act to acts "in connection with the purchase or sale of any security." This means to us that there is subject matter jurisdiction of fraudulent acts relating to securities which are committed abroad only when these result in injury to purchasers or

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33 There may be agreements made beyond our borders not intended to affect imports, which do affect them, or which affect exports. Almost any limitation of the supply of goods in Europe, for example, or in South America, may have repercussions in the United States if there is trade between the two. Yet when one considers the international complications likely to arise from an effort in this country to treat such agreements as unlawful, it is safe to assume that Congress certainly did not intend the Act to cover them.

sellers of those securities[34] in whom the United States has an interest, not where acts simply have an adverse affect on the American economy or American investors generally.[35] Also we do not think that a combination of the district court's first and third grounds, neither sufficient in

34 These may be either the very securities sold or bought or other securities of the same issue as in *Schoenbaum*.

35 The *Steele* case is distinguishable, in part on this basis. There the Bulova Watch Company, a New York corporation, brought an action in the federal District Court for the Western District of Texas for trademark infringement in violation of the Lanham Trade-Mark Act of 1946, 15 U.S.C. §§ 1051-1127, against an American citizen residing in San Antonio, Texas, who conducted a watch manufacturing business in Mexico City. By its terms the Lanham Act was intended to reach "all commerce which may lawfully be regulated by Congress." § 45. The defendant had taken advantage of the fact that the Bulova name had not been registered in Mexico. Assembling Swiss watch movements and dials and cases imported from that country and the United States, he stamped "Bulova" on his watches and sold them as such. In finding subject matter jurisdiction, the Court noted that spurious "Bulovas" had filtered back into the United States. This specific 'effect' of the assembly and distribution of these watches was reflected in the many complaints which Bulova's Texas representatives received from retail jewelers in the Mexican border area whose customers brought in for repair defective "Bulovas" which upon inspection often turned out not to be products of that company. This effect on Bulova's business within the United States was the "direct and foreseeable" result of defendant's activities in Mexico, within the meaning of § 18 of the Restatement (2d). Nothing in the *Bulova* opinion suggests that the Court would have found subject matter jurisdiction if all that was proved was that Steele's "Bulovas" gave the American watch-making industry a bad name in foreign countries.

A second distinction between the instant situation and *Steele* stems from the many delicate questions of foreign relations law that potentially may arise here, as well as the problem of judgment recognition that is discussed below, see p. 317S *infra*. Prior to the Supreme Court's decision in *Steele* the Mexican courts had nullified the defendant's registration of the Bulova name. The Court was careful to point that fact out, noting that the possibility of any potential conflict between the sovereignty of another nation and the exercise of its equity powers by the district court was thus eliminated. An analogous problem is presented here insofar as the United States may be asserting jurisdiction in order to apply its laws to activities that more properly are the subject of regulation by other sovereign states, and which currently are the subject of litigation there.

itself, supports a result different from that which would be proper if each subsisted alone.

IV. *Subject Matter Jurisdiction—Americans.*

We find it rather strange that this large record, with appendices alone running to more than 1200 pages, leaves us in serious doubt about one simple fact that seemingly could have been established quite readily. That is how plaintiff Bersch came to buy 600 shares of IOS that were part of the 3,950,000 share IOB offering.

Bersch was Vice-President and Secretary of Saja Associates Ltd., a privately-held business management and consulting firm, whose principal client was IOS, having an office in a building on Madison Avenue in New York City. His subscription was made on a form headed

> Public offering subscription form
> for Common Shares of
> I.O.S., Ltd.

We assume this emanated from Geneva. In a box bearing the legend

> Maximum dollar amount which may be subscribed:
> US $

someone had typed "6,000.00"; after the words

> Please fill in this form and return the original copy with your remittance, in the envelope supplied, to

someone had typed[36]

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36 Someone, likely whoever filled in Ms. Torres' name and address, also crossed out by typing consecutive x's the name of the organization to which the completed subscription was intended to be returned at the time of printing, namely Investors Overseas Limited, whose name and Swiss mailing address are barely discernable despite the crossing out by x's.

Juanita C. Torres
119 Rue de Lausanne Geneva

Bersch filled some other blanks, including one which indicated that he was a United States citizen and signed his name and date 9/3/69, which was three weeks before the date of the offerings and the final form of the prospectus. Bersch stated in answer to an interrogatory:

> As an officer and employee of Saja, I was told that if and when IOS went public, I would have the right to subscribe to 600 shares at the public offering price. I was informed, prior to purchase, that a telephone call had been received approving the allotment to me of 600 shares. The telephone call was made to Saja's office in New York: I was there at the time. I do not recall whether I was told the name of the person who telephoned, but in any event I do not recall his name.

It is unclear when or by whom the statement referred to in the first sentence was made; it could have been made before the offerings were even planned, perhaps as an inducement for him to join Saja. Also this leaves uncertain whether the insertion of the 6,000.00 and the name of Ms. Torres was done in Geneva on a form transmitted to New York or by someone in New York on one of a number of forms previously received from Geneva.[37] With respect to the offering prospectuses Bersch stated in answer to an interrogatory that Saja's office had copies of all three prospectuses, one of which "may" have been mailed to him at his office, that none were mailed to his home,[38] and that he read all three prior to "completing [his] purchase." However,

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37 See note 36 *supra*.

38 Three months later in an affidavit Bersch stated that one of the prospectuses had been mailed to him at his home in New York.

this tells nothing whatsoever about how two or perhaps all three of the prospectuses got to Saja's office, what led Bersch to read them, or when he did this in relation to his subscription.[39]

If the record is thus murky on how Bersch came to subscribe, it is even murkier about how other American residents did. Appellant Andersen repeatedly says that the only information on this is a statement in an affidavit of Bersch:

> I was not the only American residing here who purchased IOS stock. . . . Among the New Yorkers purchasing the IOS securities were: Christine Cullen, Naydyne Nelson, Claire Pipolo, David Ellner, Elliott Adler, Robin Leach, Robert Sutner, Raymond Grant, Simme Arthur, Hyman Feld, and Morton Schiowitz.

But this is simply not so. Much more information is furnished in a series of letters from IOS to the SEC in the fall of 1970. These indicate that sales aggregating 41,936

39 It is unclear precisely when Bersch considered his purchase to have been "completed"—by which time he claims to have read all three prospectuses. Two possible dates immediately spring to mind: September 3, 1969, when he filled out his subscription; alternatively, October 15, the date when IOS accepted the subscription for final delivery of the shares. Although appellants argue for the former, it is far from certain that Bersch did not consider the latter date to be the date of purchase. Since he was an American citizen purchasing common shares of a foreign issuer, his purchase was potentially subject to the Interest Equalization Tax, which was then still in effect, and which levied a significant tax on the acquisition of such investment interests by Americans. See IRC §§ 4911, 4920(a)(4)(A). See generally IRC §§ 4911-4921; 4931; 6011(d); 6076; 6680-81; 7241. However, since Bersch was purchasing his shares as part of a secondary offering—some of the sellers in which were American citizens—his purchase arguably fell within the prior American holder exception to the tax. IRC § 4918. On an application form, dated January 28, 1970, to the Internal Revenue Service for a "Certificate of Prior American Ownership and Interest Equalization Tax Compliance", which had been supplied to Bersch by IOS, and was signed by him, the date of purchase was stated as October 15, 1969.

shares were made to 22 American residents, all having relationships with IOS or its affiliates as employees, lawyers, directors, or consultants. Although Andersen loudly claims that Bersch and other American residents bought the shares when they knew they should not have, we find nothing in the record to support this. The IOB prospectus does not exclude American employees residing in the United States and, as indicated above, see note 7 and accompanying text, the SEC 1967 order does not clearly do so. We note also that several of the subscribers were members of law firms that had represented IOS or its affiliates; it is scarcely to be thought that they would have subscribed for shares which they knew were not intended to and could not lawfully be made available to them.

We see no reason why there would not be subject matter jurisdiction with respect to such persons on the part of defendants IOS and Cornfeld who were responsible for the IOB offering. This type of situation—the dispatch from abroad of misleading statements to United States residents—would be closely analogous to that in which jurisdiction was upheld in *Strassheim* v. *Daily, supra,* and in the *Aluminum* case and one which would be considered an appropriate subject of United States jurisdiction under § 18 of the Restatement (2d). To be sure, it may turn out that particular individuals never saw the statements or, because of their knowledge, were not misled.[40] But at the present stage we must assume that there was some mailing of prospectuses into the United States and some reliance on them. The same result should also follow with respect to Andersen; action in the United States is not necessary when subject matter jurisdiction is predicated on a direct effect here and Andersen allowed its report on the 1968

40 Presumably included within this latter group are the four alleged American resident purchasers whom Bersch also included in his list of alleged American sellers.

financial statements to be used in the IOB offering as much as in the two others. Subject matter jurisdiction with respect to the Drexel Group defendants is more debatable; this depends on whether their activities, whether in the United States or abroad, can be considered as essential to the carrying out of the IOB offering and thus of the purchases here at issue.[41] On the material before the district judge we think they can properly be, although this would be open to disproof at a trial. *Cf. Leasco*, 468 F.2d at 1330. Whether the same is true with respect to Crang is more debatable since the IOB offering was far more dependent on the large Drexel offering throughout the world than on the much smaller Canadian offering by Crang, but in view of our approval of the court's holding of lack of in personam jurisdiction over Crang, we need not decide this.

Plaintiff asserts that, in addition to purchases by Americans resident in the United States, there were significant purchases by Americans resident abroad.[42] Whether Congress intended that such persons should be entitled to obtain damages for violation of the securities laws is a different and closer question from that on which we have just

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41 The argument for so holding would be that the public underwriting was an almost necessary component of the secondary IOB offering, because (1) a large public market was established in which purchasers under the secondary offering might dispose of their shares—in any case this increased liquidity of the shares made the secondary offering more attractive; (2) a greater degree of credibility was accorded the IOB offering by the fact that a public offering was being made by respected investment banking houses; (3) although arguably a large secondary offering could have created a quasi-public market, such an offering alone might have appeared too much like a bail out.

42 In response to inquiries by the SEC with respect to whether, and to what extent, Americans had purchased IOS shares at the "public offering", IOS' counsel admitted that approximately 385 "American persons" were known to have acquired such shares. Since many shares of IOS were held in the form of bearer share warrants, making it impossible to determine the ownership thereof, many additional Americans may have in fact been purchasers.

ruled. We think the answer would be in the negative if none of the defendants engaged in significant activities within the United States, as defendants, with apparent soundness, claim to be the case with respect to the IOB offering considered alone. Congress surely did not mean the securities laws to protect the many thousands of Americans residing in foreign countries against securities frauds by foreigners acting there, and we see no sufficient reason to believe it would have intended otherwise simply because an American participated so long as he had done nothing in the United States. However, in Judge Carter's view the IOB offer to American citizens residing abroad would not have occurred but for the primary offering which involved the many documented activities of the defendants in the United States.[43] There was enough basis for this to justify a holding of subject matter jurisdiction as regards American citizens residing abroad, with respect to IOS and Andersen. Despite the paucity of physical acts on its part in the United States, the head and front of its alleged offending was its decision to allow its 1968 report to be used in all three prospectuses, including the IOB prospectus, and this must have emanated from its headquarters in the United States. We are of the same view with respect to the Drexel group. While merely preparatory activities in the United States are not enough to trigger

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43 While plaintiff is necessarily speculating, there appears to be substantial logic in his assertion that the primary and secondary features of the offering were necessary concomitants. The latter, which is an opportunity for management to realize on their investment, provides the incentive for the primary offering. The primary offering managed by Drexel creates the market for management to realize its profit in the secondary offering managed by Crang and I.O.S. While this relatedness of purpose is difficult to document, sufficient ties have been demonstrated to support plaintiff's contention that the three offerings were so integrated as to have their prime movers collectively considered for purposes of subject matter jurisdiction.

application of the securities laws for injury to foreigners located abroad, they are sufficient when the injury is to Americans so resident. We here assume that, for reasons stated in the preceding paragraph, proof will disclose a significant causal relationship between the Drexel offering and the IOB offering. The case with respect to Crang is weaker but, since we sustain the judge's ruling of lack of *in personam* jurisdiction, we need not reach it. This leaves Cornfeld; the question of how far the alleged defrauding of American citizens abroad resulted from acts which he did or caused in the United States had best be left for development at a trial. We again invite attention to our observation in *Leasco*:

> We add that if a trial should disclose that the allegedly fraudulent acts of any of the defendants within the United States were nonexistent or so minimal as not to be material, the principles announced in this opinion should be applied to the proven facts: the issue of subject matter jurisdiction persists.

468 F.2d at 1330.

We have thus concluded that the anti-fraud provisions of the federal securities laws:

> (1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
>
> (2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the United States have significantly contributed thereto; but

(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses.

Other fact situations, such as losses to foreigners from sales to them within the United States, are not before us. We freely acknowledge that if we were asked to point to language in the statutes, or even in the legislative history, that compelled these conclusions, we would be unable to respond. The Congresses that passed these extraordinary pieces of legislation in the midst of the depression could hardly have been expected to foresee the development of off-shore frauds thirty years later. We recognize also that reasonable men might conclude that the coverage was greater, or less, than has been outlined in this opinion and in *IIT* v. *Vencap, Ltd.*, this day decided. Our conclusions rest on case law and commentary concerning the application of the securities laws and other statutes to situations with foreign elements and on our best judgment as to what Congress would have wished if these problems had occurred to it.[44]

V. *Class Action.*

If what was before us was a single action with only named plaintiffs of the three sorts above described or three separate actions on behalf of the respective classes, we could promptly proceed to decision. Unhappily that is not the case. Appellants contend that once we have determined that the federal securities laws do not apply to the sales to

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44 For a consideration of the issues presented by the extraterritorial application of Rule 10b-5 see Mizrack, *Recent Developments in the Extraterritorial Application of Section 10(b) of the Securities and Exchange Act of 1934*, 30 Bus. Lawyer 367 (1975); Comment, *The Transnational Reach of Rule 10b-5*, 121 Penn. L. Rev. 1363 (1973).

foreign purchasers, they must be stricken from the class. Plaintiff says that all that is before us is whether the action may be maintained on behalf of some of the purchasers and that, since we have decided it can be, that is the end of the matter; alternatively, if we should reach the issue, the district court could entertain the claims of the foreign plaintiffs as pendent claims for common law fraud.

We must first deal with plaintiff's contention that the question of the inclusion of the foreign purchasers is not properly before us because it was not within Judge Carter's § 1292(b) certificate and that we are limited to a remand to the district court for further consideration of the class action determination in light of our decision. The action would then proceed on whatever basis that court decided, with dubious possibilities of review by aggrieved parties at that time, although the propriety of that court's determination would, of course, come before us on any appeal from a final judgment.

Even if we were limited to the four corners of the certificate,[41a] we would not accept plaintiff's argument. The

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44a The defendants have asked that the court's determination that it has subject matter jurisdiction and *in personam* jurisdiction over I.O.S. and Cornfeld filed this day be certified for appeal to the United States Court of Appeals pursuant to 28 U.S.C. § 1292(b). The issue of subject matter jurisdiction clearly meets the statutory criteria. While the jurisdictional reach of our securities laws has been settled and clarified by our Court of Appeals in *Schoenbaum* v. *Firstbrook*, 405 F. 2d 215 (2d Cir. 1968) and *Leasco Data Processing Corp.* v. *Maxwell*, 468 F. 2d 1326 (2d Cir. 1972), there is substantial ground for difference of opinion as to whether the *ratio decidendi* of those cases was properly applied in the instant case. Moreover, the question of subject matter jurisdiction is a controlling issue of law in this case. If the court is in error, the whole controversy could be terminated. The basis for the court's determination was that the tripartite offerings involved were an integrated entity and not three distinct, separate and independent transactions. An immediate appeal, if the court is in error, will materially advance the ultimate determination of the controversy and "would save • • • the cost and delay of protracted and expensive litigation." *Bobolakis* v. *Compania Panamena Maritima San Gerassimo*, 168 F.

district judge must have recognized the possibility that we might decline to accept his integration theory in its fullest reach, and also his reliance on general economic effects in the United States, yet uphold subject matter jurisdiction with respect to plaintiffs who had been directly affected in this country or to American citizens who had purchased abroad. We do not believe he meant that, in that event, we should be limited to declaring our own views and be powerless to discharge the normal responsibilities of an appellate court to determine their consequences. When he said that a decision by this court would materially advance the ultimate determination of the controversy and, quoting from *Bobolakis* v. *Compania Panamena Maritima San Gerassimo*, 168 F. Supp. 236, 240 (S.D.N.Y. 1958), "would have . . . the cost and delay of protracted and expensive litigation," he could hardly have been blind to the savings that would result from a ruling on our part that the action could not be maintained on behalf of the many thousands of foreign purchasers if that was our conclusion.

Moreover, as we have recently held, our powers on an appeal under § 1292(b) are not so narrowly circumscribed as to preclude consideration and resolution of questions other than those specifically regarded as controlling by the district court at the time of its certification order. See *Capital Temporaries, Inc.* v. *Olsten Corp.*, 506 F.2d 658, 660 (2 Cir. 1974). See also *Katz* v. *Carte Blanche Corp.*, 496 F.2d 747, 754 (3 Cir. 1974), *cert. denied*, 43 U.S.L.W. 3213 (U.S., Oct. 15, 1974). Compare *Hurwitz* v. *Directors Guild of America, Inc.*, 364 F.2d 67, 70 (2 Cir.), *cert. denied*, 385, 971 (1966). Perhaps in awareness of the difficulties that had arisen with respect to propounding certified questions to the Supreme Court under 28 U.S.C. §§ 1254 and 1255,

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Supp. 236, 240 (S.D.N.Y. 1958). Therefore, the request that the determination in respect of subject matter jurisdiction be certified for appeal pursuant to 28 U.S.C. § 1292(b) is granted.

see Stern & Gressman, *Supreme Court Practice* Ch. 9, pp. 385-89 (4th ed. 1969); Moore & Vestal, *Present and Potential Role of Certification in Federal Appellate Procedure*, 35 Va. L. Rev. 1, 10-25 (1949), Congress wrote § 1292(b) differently. While the district court judge is required to state what he considers to be "a controlling question of law," the appeal is from the order—here an order upholding subject matter jurisdiction over a class action in which all purchasers in all three IOS offerings were the plaintiff class. See *Johnson* v. *Alldredge*, 488 F.2d 820, 823 (3 Cir. 1973), *cert. denied sub. nom, Cronrath* v. *Johnson*, 43 U.S.L.W. 3213 (U.S., Oct. 15, 1974). See also 9 Moore, Federal Practice ¶ 110.25 [1] at 269-73 (1973). This conclusion as to the broad scope of our review power under § 1292(b) is consistent with the principal purpose of that section as evidenced in its lengthy legislative history. Section 1292(b) was the result of dissatisfaction with the prolongation of litigation and with harm to litigants uncorrectable on appeal from a final judgment, sometimes resulting from strict application of the federal final judgment rule. It was thus designed to cure these difficulties by permitting speedy determination of debatable legal issues, the resolution of which might greatly advance the ultimate determination of the controversy, without requiring the parties first to participate in a trial. See 3 U.S. Code Cong. & Adm. News, 85th Cong., 2d Sess. 5255-5263 (1958); *Hearings Before House Subcomm. No. 3 of the House Comm. on the Judiciary on H.R. 6238*, 85th Cong., 2d Sess. (1958), H.R. Rep. No. 1667, 85th Cong., 2d Sess. 1-2 (1958); S. Rep. No. 2434, 85th Cong., 2d Sess. 3-4 (1958); *Milbert* v. *Bison Laboratories*, 260 F.2d 431, 433-35 (3 Cir. 1958) *(en banc)*; Note, *Federal Appealability*, 75 Harv. L. Rev. 351, 379 (1961).

In arguing against retention of foreign purchasers in the class, appellants rely heavily on *Zahn* v. *International*

Paper Co., 414 U.S. 291 (1973). At first blush the case would scarcely seem pertinent since its precise holding was merely that except when aggregation was permissible, each member of the class and not simply the named plaintiffs must have a claim exceeding $10,000 when that was required as a jurisdictional amount, and no such amount is required for an action under the securities laws. However, appellants find *Zahn* to have declared a more general principle, namely, "that a person who cannot sue in the federal courts as a named plaintiff because of lack of jurisdiction over his claim, may not be part of a class represented by a named plaintiff over whose claim the federal court has jurisdiction," Andersen brief at 57. The argument continues that if such jurisdiction were claimed to exist for the foreign purchasers on the basis of 28 U.S.C. § 1332, this would be destroyed by the lack of diverse citizenship as between plaintiff Bersch and some of the defendants, and that in any event it is most unlikely that each foreign purchaser has a claim exceeding $10,000.

Regrettably plaintiff has not favored us with a response, preferring to rest on his claim, with which we disagree for reasons just developed, that the issue is not before us. Although certain commentators apparently view the effect of *Zahn* to be limited to cases where a jurisdictional amount was required, see, e.g., Note, *The Supreme Court, 1973 Term*, 88 Harv. L. Rev. 40, 49 (1974), the dissents of Judge Timbers in this court, 469 F.2d at 1037-38, and Mr. Justice Brennan in the Supreme Court, 414 U.S. at 302, had pointed to possible broader implications, which have been recognized by other commentators. See, e.g., Note, *Ancillary Jurisdiction and the Jurisdictional Amount Requirement*, 50 Notre Dame Lawyer 346, 350-63 (1974) (potential implications for ancillary jurisdiction doctrine with respect to (1) Intervention—Fed. R. Civ. P. 24; (2) Impleader—

id. 14(a); (3) Crossclaims—*id.* 13(g); (4) Compulsory Counterclaims—*id.* 13(a); (5) Interpleader—*id.* 22). If *Zahn* means what appellants assert, it would run counter to the ruling in *Supreme Tribe of Ben-Hur* v. *Cauble,* 255 U.S. 356 (1921), where the Court held that the complete diversity necessary under *Strawbridge* v. *Curtiss,* 3 Cranch (7 U.S.) 267 (1806), was not destroyed by the intervention as plaintiffs in a class action of a class having the same citizenship as the defendant—unless this portion of *Ben-Hur* rests on the distinction between being originally named and later intervening as plaintiffs. Cf. *Wichita R.R. & Light Co.* v. *Public Service Comm'n,* 260 U.S. 48, 54 (1922). Appellants could respond that fragile as this distinction may seem, it is the only satisfactory basis for reconciling *Ben-Hur* with *Zahn* itself.[45]

We think it unnecessary to resolve this difficult issue, an attempt that might lead us into the effect of the rationale alleged to underlie *Zahn* upon such developments in the law of pendent jurisdiction as our decisions in *Astor-Honor, Inc.* v. *Grosset & Dunlop, Inc.,* 441 F.2d 627, 629-30 (2 Cir. 1971), and *Leather's Best, Inc.* v. *S.S. Mormaclynx,* 451 F.2d 800, 809-10 (2 Cir. 1971). See Hart & Wechsler, The Federal Courts and the Federal System 1078-81 (2d ed. 1973), and D. Currie, Federal Courts: Cases and Materials 394-97, 520-22 (2d ed. 1975). Even if we were to assume that the district court has power to retain the foreign purchasers in the class and entertain the state law claims, it would be an abuse of discretion for it to do so. *United Mine Workers* v. *Gibbs,* 383 U.S. 715, 726-27 (1966).

In terms of the amount at stake it is almost ludicrous to speak of the claims of the foreign purchasers as "pendent". Since the relatively few purchasers with federal

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45 The dissenters in *Zahn* strongly urged the authority of *Ben-Hur,* 414 U.S. at 308-10, but the majority did not respond.

claims will almost inevitably rely on the stricter standard of the federal securities laws, entertaining the state law claims of the foreign purchasers would, as a practical matter, introduce a whole new set of issues, including issues of choice of law and, if it were to be decided that New York would look to the laws of the countries where the sales were made, the ascertainment and application of the laws of at least fourteen different nations. As Judge Frankel observed in *Investment Properties Int'l, Ltd.* v. *I.O.S., Ltd.*, CCH Fed. Sec. L. Rep. [1970-1971 Transfer Binder] ¶ 93,011, 90.735 (S.D.N.Y.), *aff'd without opinion* (2 Cir. 1971) (unreported):[46]

> If there is no such domestic impact from a substantially foreign transaction, United States courts have no reason to become involved, and compelling reason *not* to become involved, in the burdens of enforcement and the delicate problems of foreign relations and international economic policy that extraterritorial application may entail. (Emphasis in original.)

The management of a class action with many thousands of class members imposes tremendous burdens on overtaxed district courts, even when the class members are mostly in the United States and still more so when they are abroad.[47]

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46 See *Investment Properties Int'l, Ltd.* v. *I.O.S., Ltd.*, 459 F.2d 705, 706 n.1 (2 Cir. 1972).

47 This is illustrated by the problem of notice. On the facts of this case one must have pause over sending notices only in English, as was directed in connection with the proposed settlement. The fact that the Drexel prospectus stated "[t]he English language version . . . shall control any question arising from its translation into other languages", thereby apprising non-English speaking purchasers that the English language might possibly become relevant to the final determination of their rights, in no way justifies notice only in English. On the other hand, if notice is to be sent in several languages, can the court simply delegate responsibility to insure accuracy?

Also, while an American court need not abstain from entering judgment simply because of a possibility that a foreign court may not recognize or enforce it, the case stands differently when this is a near certainty. This point must be considered not simply in the halcyon context of a large recovery which plaintiff visualizes but in those of a judgment for the defendants or a plaintiffs' judgment or a settlement deemed to be inadequate. As Judge Frankel stated in his order permitting the case to proceed as a class action:

> if defendants prevail against a class they are entitled to a victory no less broad than a defeat would have been.

Here the record contains uncontradicted affidavits that England, the Federal Republic of Germany, Switzerland, Italy, and France would not recognize a United States judgment in favor of the defendant as a bar to an action by their own citizens, even assuming that the citizens had in fact received notice that they would be bound unless they affirmatively opted out of the plaintiff class,[48] and another affidavit recites that several hundred claims, including those of at least eighteen Americans, against defendant Cornfeld are pending in Switzerland[49] and that at least

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48 These affidavits further state that although the binding effect of a foreign class action judgment upon non-appearing members of the class had not been decided by a court in any of these jurisdictions, had an "opt in" form of notice—one which required a class member to sign and return a writing agreeing to be bound by any judgment in the proceeding—been adopted by the district court as urged by certain of the defendants, it was far more likely, although still not certain, that in several of these jurisdictions a prior judgment for defendant in the class action would serve as a bar to an action by any person who had joined the class.

49 A criminal proceeding was instituted in November, 1971 against Cornfeld. Swiss law permits intervention by civil parties in a criminal proceeding, and pursuant to such intervention at least 395 claimants of 22 nationalities have sought full reparations for any damages they may have suffered as a result of their purchases.

ninety have been settled. The affidavits are consistent with the conclusion in Von Mehren and Trautman, Recognition of Foreign Adjudications: A Survey and a Suggested Approach, 81 Harv. L. Rev. 1601 (1968), that European courts are far less inclined to recognize foreign judgments than are American courts applying the principles of *Hilton* v. *Guyot*, 159 U.S. 113, 202-03 (1895). We do not find it a satisfactory answer that here the defendants may be protected by the running of the statute of limitations in foreign countries. Nothing like a complete survey has been made and apparently the statute will not run in France until 1999. Moreover, in a situation like this, defendants should be entitled to a decision concerning the claims of foreign plaintiffs early in the progress of the litigation.

Against this plaintiff urges that foreign purchasers may have abstained from bringing timely suits in their own countries because of reliance on Judge Frankel's determination.[50] Whatever force this might or might not have had if plaintiff had then given notice pursuant to Fed. R. Civ. P. 23(c)(2), as we now know to be required at some stage, *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 172-77 (1974), none was. If it had been, it would have had to disclose that the class action determination was expressly subject to reconsideration.

We therefore direct that the district court eliminate from the class action all purchasers other than persons who were residents or citizens of the United States.

There are other problems concerning the future of this action which we leave to the district court since further factual inquiry is needed. The class of residents to whom

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50 Counsel for plaintiff tells us that a Swiss attorney representing plaintiffs in the action then pending visited him in New York for the purpose of "intervening" these claimants in the instant action and that counsel advised this was unnecessary in light of Judge Frankel's ruling. But that ruling was stated to be subject to reconsideration, as it necessarily was under Fed. R. Civ. P. 23(a).

sales were made in the United States may prove to be so small as to create questions whether this group meets the numerosity requirement of Fed. R. Civ. P. 23(a), particularly since some may not desire to sue,[51] and whether in view of the fact that they were all or predominantly "insiders" of one sort or another, "the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy." Fed. R. Civ. P. 23(b)(3).[52] There is also a question whether if plaintiff Bersch did not rely on the prospectus in making his purchase, see note 39 *supra*, he can properly represent them. If this is resolved favorably to Bersch, there is a further question whether he should also be allowed to represent United States citizens who purchased IOS shares abroad. Perhaps still other questions will arise.

VI. *In Personam Jurisdiction—Crang.*

In dealing with jurisdiction over the person of Crang, we turn, as did the district court, to Part III of our decision in *Leasco*, 468 F.2d at 1339-44. We there held "that Congress meant § 27 [of the Securities Exchange Act] to extend personal jurisdiction to the full reach permitted by the due process clause" and that the boundaries of this, in the

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51 See also note 40 *supra*.

52 Other difficulties are created by the fact that plaintiff's complaint alleges that in addition to the fraudulent nature of the three offering prospectuses, the purchaser class was defrauded by statements by Mr. Cornfeld and other IOS officials concerning IOS's financial prospects and business operations made at press conferences, in speeches, magazine articles and brochures, as well as on television. Since these statements were apparently disseminated in various forms throughout the world, with only a limited portion of the composite likely having been received by a particular class member, separate proof of reliance, materiality, and causation may be required for each class member.

case of a defendant not personally present at the time of service, were set forth in §§ 35, 36 and 37 of the Restatement (2d) of Conflict of Laws, which themselves in large part merely amplify the central idea contained in the Supreme Court's most recent statement on the subject in *Hanson* v. *Denckla*, 357 U.S. 235, 253 (1958) that it is "essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws."

The first of these, § 35, "Doing Business in State",[53] requires little comment. It is not even contended that Crang comes within (3); although it once had a branch office in New York, this was discontinued several months prior to the IOS offering and long before process was served. Crang's current business, so far as the United States is concerned, consists of buying and selling for Americans securities traded on Canadian markets and arranging with American brokers for its Canadian customers to buy or sell securities traded in American markets.[54] This is not doing business within the United States; if it were, every securities dealer of any significant

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53 § 35. Doing Business in State

(1) A state has power to exercise judicial jurisdiction over an individual who does business in the state with respect to causes of action arising from the business done in the state.

(2) A state has power to exercise judicial jurisdiction over an individual who has done business in the state, but has ceased to do business there at the time when the action is brought, with respect to causes of action arising from the business done in the state.

(3) A state has power to exercise judicial jurisdiction over an individual who does business in the state with respect to causes of action that do not arise from the business done in the state if this business is so continuous and substantial as to make it reasonable for the state to exercise such jurisdiction.

54 As to these latter transactions Crang received no commission.

size anywhere in the world would be "doing business" here.[55] The situation is not changed by the fact that on one occasion in April 1969 a Crang partner visited four New York investment houses in an apparent attempt to drum up trade.[56] No evidence has been adduced of any more recent solicitations of business in the United States by Crang. Even assuming representatives of Crang sporadically visit investment banks and brokerage firms in the United States to solicit the type of business discussed above, this would hardly constitute "doing business" in the sense in which that concept has been developed, even subsequent to the liberalization of personal jurisdiction principles accomplished by *International Shoe Co.* v. *Washington*, 326 U.S.

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55 Plaintiff also relies on two SEC broker-dealer registrations, one in 1956 and the other in 1970, copies of which were annexed to its brief. These papers were not called to the attention of the district court and thus are not properly before us, see, e.g., *Dictograph Prods. Co.* v. *Sonotone Corp.*, 231 F.2d 807 (2 Cir.), *appeal dismissed per stip.*, 352 U.S. 883 (1956); *Jaconski* v. *Avison Corp.*, 359 F.2d 931, 936 n.11 (3 Cir. 1966); *United States* v. *Summit Fidelity & Surety Co.*, 408 F.2d 46 (6 Cir. 1969); if plaintiff considered them sufficiently important, he should have moved to reopen the record. In fact the papers do not advance plaintiff's cause. We are told by Crang that the 1956 registration related to the former New York office which was closed effective April 1, 1969 and that the 1970 registration was by a successor corporation and not by the partnership that is here being sued. Plaintiff's statement "Defendant Crang executed a consent to the service of process upon the SEC which was operative during the relevant period" is misleading both on these grounds and because the consent in the 1956 registration was only "that notice of any proceeding before the Commission in connection with the application or with registration thereunder may be given [to the person named below]." The consent in the 1970 form is similar. Neither is a general consent to service of process.

56 By deposition the Crang partner stated that during 1969 he visited New York only four, or at most, five times. In addition to the trip just discussed and one relating to a breakfast meeting with Cowett of IOS discussed at pp. 3183-3184 *infra*, he recalled one trip which essentially had been a social call on the owner of a Canadian securities firm and another which had been devoted to purchasing furniture for his wife.

310 (1945), and *Hanson* v. *Denckla, supra.* See, e.g., *Bryant* v. *Finnish Nat'l Airline,* 15 N.Y.2d 426 (1965). Beyond this, except when the doing of business is "so continuous and substantial as to make it reasonable" for the state to go further, see *Perkins* v. *Benquet Consolidated Mining Co.,* 342 U.S. 437 (1952), "doing business" affords jurisdiction only for causes of action arising from the business being done.

We likewise find no basis for in personam jurisdiction under § 36 ("Doing an Act in State").[57] Crang's only acts in the United States having any relation to its underwriting of IOS shares were two breakfast meetings at the Carlyle Hotel in New York between its partner Howe and Edward Cowett, IOS's chief attorney and one of the principal architects of its organizational structure and operations, who apparently was the central IOS officer involved in the planning and execution of the offering. According to the uncontradicted deposition of Howe the first meeting occurred in late April as a result of a chance encounter the previous day at the office of a mutual business acquaintance. The principal reason for that meeting was to discuss an upcoming quarterly dividend payment of Investors Overseas Management Corp. (ISM), an IOS subsidiary of which both Howe and Cowett were directors and which managed the mutual funds distributed by IOS. During this one hour meeting the "concept" of IOS' going public, a subject which previously had been explored by them several weeks before in Geneva, was discussed.[58] Howe considered IOS to

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57 § 36. *Doing an Act in State.*

(1) a state has power to exercise judicial jurisdiction over an individual who has done, or has caused to be done, an act in the state with respect to any cause of action in tort arising from the act.

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58 Howe considered the idea of IOS's going directly public at that time to be only a concept, instead of a definite plan the details of which

be "a very exciting company" and urged Cowett to permit Crang to manage the Canadian underwriting, if not the entire underwriting. Cowett apparently rejected the latter proposal since Crang was "strictly Canadian and this would be a world-wide underwriting." Although the capital structure of the new corporate vehicle and possible dividend policy, as well as the terms—but not the market price—and timing of the issue, were discussed in general terms, these discussions were apparently of a preliminary nature with no detailed recommendations, and certainly no final decisions, being made. Whatever the situation may be with respect to subject matter jurisdiction, the connection between these meetings and the injuries to American residents or American citizens abroad from the IOB underwriting was too tenuous to permit those torts to be considered as "arising from" Howe's two breakfasts. There remains for consideration § 37 ("Causing Effects in State by Act Done Elsewhere").[59] The plaintiff's argument here that, under the judge's "integration" theory, everything done by Crang with respect to the IOS underwriting was a "cause" of injuries to the plaintiffs who were residents of the United States raises again the question we did not decide in our discussion of subject matter jurisdiction. We think it unnecessary to do so in this context since, even assuming that because of the integrated nature of the underwritings Crang's acts had some causal relation to the al-

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remained to be considered, since for many years the strategy had been to take each of IOS' subsidiaries public prior to an offering of the parent. See pp. 3141-3142 *supra*.

59 § 37. *Causing Effects in State by Act Done Elsewhere.*
A state has power to exercise judicial jurisdiction over an individual who causes effects in the state by an act done elsewhere with respect to any cause of action arising from these effects unless the nature of the effects and of the individual's relationship to the state make the exercise of such jurisdiction unreasonable.

leged injuries to purchasers of the IOB offering who were American residents or United States citizens, we believe the test for *in personam* jurisdiction is somewhat more demanding. We said with respect to § 37 in *Leasco*, 368 F.2d at 1341, that "this is a principle that must be applied with caution, particularly in an international context", see Von Mehren & Trautman, *Jurisdiction to Adjudicate: A Suggested Analysis*, 79 Harv. L. Rev. 1121, 1127 (1966), and suggested that at minimum the effect within the state must occur "as a direct and foreseeable result of the conduct outside the territory," the language of § 18 of the Restatement (2d) of Foreign Relations Law. Indeed, § 37 itself contains the important qualification "unless the nature of the effects and of the individual's relationship to the state makes the exercise of such jurisdiction unreasonable." While Crang knew of the IOB underwriting, there is nothing to show it had knowledge that some of the purchasers would be persons residing in the United States or United States citizens residing abroad.

We therefore affirm the order dismissing the complaint against Crang for lack of *in personam* jurisdiction.[60]

VII. *Mandamus Sought by IOS and Cornfeld.*

IOS and Cornfeld have submitted petitions for mandamus seeking review of the judge's unfavorable rulings with respect to the manner of service of process and inexcusable delay.[61] These rulings, whether right or wrong,

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60 In light of this holding we have no occasion to consider Crang's argument that it comes within the exemption provided in § 30(b) of the Securities Exchange Act, see note 20 *supra*. Compare *Kook* v. *Crang*, 182 F. Supp. 388, 390-91 (S.D.N.Y. 1960).

61 Section 22(a) of the Securities Act of 1933 and § 27 of the Securities Exchange Act expressly authorize extra-territorial service in any district "of which the defendant is an inhabitant or wherever the defendant may be found." The manner of service is prescribed by Fed. R. Civ. P.

are not appropriate for the issuance of this extraordinary writ.

IOS' application also sought review of the district court's refusal to step aside with respect to it in favor of the New Brunswick liquidation. Compare *Canada Southern Ry. Co.* v. *Gebhard*, 109 U.S. 527 (1883); *Pennsylvania* v. *Williams*, 294 U.S. 176 (1935). The district court gave no reasons for its refusal. We think it should have done so. However, it is possible that, in light of our decision, IOS may be satisfied to have this litigation proceed before the district court. If not, it should renew its application for a stay and the district judge should rule upon it, and if the ruling be adverse, IOS may apply to us again.

The order is reversed insofar as it sustains subject matter jurisdiction with respect to all purchasers of IOS securities and is affirmed insofar as it sustains such jurisdiction with respect to purchasers who were American residents or citizens. The cause is remanded with directions

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4(i)(1)(D) which provides for service "by any form of mail, requiring a signed receipt to be addressed and dispatched by the clerk of the court to the party to be served." Although Bersch filed his complaint in 1971, no attempt to serve Cornfeld was made until May 15, 1973 when a summons and complaint were made on a Ms. Diethild Gainer at a residence in Beverly Hills, California. At that time Cornfeld was being held in St. Antoine Prison, Geneva, Switzerland. In September, 1973 plaintiff obtained a summary default order against Cornfeld which was vacated in December of that year. Cornfeld was finally served by mail at St. Antoine Prison in February, 1974. Three attempts were made to serve IOS. The first was in 1972 to an English address which it apparently did not then occupy and was returned marked "Refused" along with some markings that appear to be initials. In February, 1974 two additional attempts were made to serve IOS by sending letters to its former principal executive offices in Geneva and to its New Brunswick headquarters. For several reasons not necessary to consider here IOS contends that it was not "found" at any of these addresses, and that even if it were, none of the attempted services were in conformity with the procedural requirements of Rule 4(i)(2).

to modify the class action determination insofar as this includes purchasers who were not American residents or citizens and to consider whether the action should be allowed to proceed as a class action with respect to one or both such classes, in light of the discussion in this opinion. The stay of mailing and publishing notice of the proposed settlement is made permanent. The order dismissing the complaint against Crang for lack of *in personam* jurisdiction is affirmed. The petitions for mandamus are denied except that with respect to so much of IOS' petition as relates to the refusal of a stay, the denial is without prejudice, as aforesaid. No costs, except in favor of Crang.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twenty-third day of July, one thousand nine hundred and seventy-five.

Present: HON. HENRY J. FRIENDLY,

HON. WILLIAM H. MULLIGAN,

HON. WILLIAM H. TIMBERS,

Circuit Judges.

Howard Bersch,	:	
Plaintiff-Appellant,	:	
v.	:	
Drexel Firestone, Inc., Drexel Harriman	:	75-7031
Ripley, Banque Rothschild, Hill Samuel	:	75-7038
& Co., Ltd., Guinness Mahon & Co., Ltd.,	:	75-7055
Pierson, Helding & Pierson, Smith,	:	75-7057
Barney & Co., Inc., J. H. Crang & Co.,	:	
Investors Overseas Bank Ltd., Arthur	:	
Andersen & Co., I.O.S. Ltd., and	:	
Bernard Cornfeld,	:	
Defendants,	:	
J. H. Crang & Co.,	:	
Defendant-Appellee.	:	
	:	

A petition for a rehearing having been filed herein by counsel for the plaintiff (Bersch)

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. DANIEL FUSARO
Clerk

By: /s/ Vincent A. Guardero
Chief Deputy Clerk

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the twenty-third day of July, one thousand nine hundred and seventy-five.

Howard Bersch, Plaintiff-Appellant,	:	
v.		
Drexel Firestone, Inc., Drexel Harriman Ripley, Banque Rothschild, Hill Samuel & Co., Ltd., Guinness Mahon & Co., Ltd., Pierson, Helding & Pierson, Smith, Barney & Co., Inc., J. H. Crang & Co., Investors Overseas Bank Ltd., Arthur Andersen & Co., I.O.S. Ltd., and Bernard Cornfeld,	:	75-7031
Defendants,	:	
J. H. Crang & Co., Defendant-Appellee.	:	

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the plaintiff (Bersch), and no active judge or judge

who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and it hereby is denied.

/s/ IRVING R. KAUFMAN
Chief Judge

APPENDIX E

Statutes Involved

The following statutes are involved in this case:

Section 12 of the Securities Act of 1933, 15 USC §771, provides:

Any person who -

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 15 of the Securities Act of 1933, 15 USC §77o, provides:

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

Section 17 of the Securities Act of 1933, 15 USC §77q, provides:

(a) It shall be unlawful for any person in the offer or sale of any securities by

the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

Section 10(b) of the Securities Exchange Act of 1934, 15 USC §78j(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 15(c)(1) of the Securities Exchange Act of 1934, 15 USC §78o(c)(1) provides:

> No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

Section 20 of the Securities Exchange Act of 1934, 15 USC §78t, provides:

(a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

(b) It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this chapter or any rule or regulation thereunder through or by means of any other person.

(c) It shall be unlawful for any director or officer of, any owner of any securities issued by, any issuer required to file any document, report, or information under this chapter or any rule or regulation thereunder without just cause to hinder, delay, or obstruct the making or filing of such document, report or information.

Section 30 of the Securities Exchange Act of 1934, 15 USC §78dd, provides:

(a) It shall be unlawful for any broker or dealer, directly or indirectly, to make

use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident of, or is organized under the laws of, or has its principal place of business in, a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors or to prevent the evasion of this chapter.

(b) The provisions of this chapter or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this chapter.

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1975

No._____

HOWARD BERSCH,
Petitioner,

v.

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,
Respondents.

NOTICE PURSUANT TO
SUPREME COURT RULE 21(6)

I hereby certify that, in the opinion of petitioner, J. H. Crang & Co., a party in the Court of Appeals for the Second Circuit, has no interest in the outcome of this petition. A copy of this notice has been appended to each copy of the within Petition being served on all parties.

Sidney B. Silverman

Dated: New York, New York
October 20, 1975

Supreme Court, U. S.
FILED
NOV 10 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1975

No. 75-596

HOWARD BERSCH,

Petitioner,

v.

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR ARTHUR ANDERSEN & CO. IN OPPOSITION

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November 6, 1975

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BRIEF FOR ARTHUR ANDERSEN & CO. IN OPPOSITION

Questions Presented for Review

(1) Did the Court of Appeals misapply the federal securities laws and commit error when it held that their anti-fraud provisions do not apply to the sale to non-resident aliens of the United States of the securities of a foreign corporation, which does not have an office in the United States; whose securities are not traded in the United States; where all sales of its securities were made outside the United States; where the prospectuses were prepared, printed and delivered in foreign countries; where the stock was deliv-

ered and paid for in foreign countries; and where the loss suffered by such non-resident aliens was not caused either by an act committed within the United States or by a culpable failure to act within the United States?

(2) Did the Court of Appeals abuse its discretion and commit error when it held that a purported class consisting of 100,000 purchasers of stock of a foreign corporation, 99.65% of which consists of non-resident aliens who bought their stock abroad in countries such as Europe, Asia, Africa, Australia and South America, is not manageable and, accordingly, directed elimination from the class of all such non-resident aliens?

Statement of the Case

I.O.S., Ltd. ("IOS"), which made three public common stock offerings in September 1969, by three separate prospectuses, is a foreign corporation with its principal office in Geneva. It never had an office in the United States and its stock was never listed on a stock exchange in the United States or traded over the counter in this country. Before such public offerings, there was no market for IOS common stock anywhere in the world, and there has never been a market for such stock in the United States.

Furthermore, as the Court of Appeals stated (6b-7b),* on May 23, 1967, IOS and its affiliates were barred by an SEC order from engaging in any activity subject to its jurisdiction and from selling securities to United States citizens or nationals wherever located, except that sales could be made outside the United States to IOS insiders, such as officers, directors and full-time personnel (192A—109A-118A).**

* References to ("——a") and ("——b") are to the appendix to the petition.

** References to ("——A") are to the four-volume appendix before the Court of Appeals.

Respondent Arthur Andersen & Co. ("Andersen"), an international accounting firm, is sued since its Zurich office audited the IOS financial statements and consented to use of Andersen's reports in the prospectuses (178A).

One of the three September 1969 public offerings consisted of a primary offering of 5,600,000 shares underwritten by Drexel Harriman Ripley, a Wall Street firm ("Drexel"), Banque Rothschild of Paris, Hill, Samuel & Co., Limited, of London, Guinness, Mahon & Co. Limited of London, Pierson, Heldring & Pierson of Amsterdam, Holland, and Smith, Barney & Co., also a Wall Street firm (168A). There were 116 additional firms in 44 countries in Europe, Asia and Australia which acted as underwriters and dealers in the sale of the IOS stock in their respective countries (175A-176A). While 25 of such 116 firms were American, their solicitation and selling activities took place entirely outside the United States, as required by an agreement to limit all such activities to areas in Europe, Asia and Africa.

The Drexel prospectus stated on its cover page that the shares were not registered under the federal securities act and were not being offered in the United States, Canada or Mexico, and were not being offered to United States nationals or citizens who resided abroad, or to United States residents, or to IOS directors, officers or full-time employees (168A). The District Court found that "no sales to Americans did occur" through the Drexel offering (18a).

There was a secondary offering in Canada of 1,450,000 shares underwritten by Canadian firms managed by defendant J. H. Crang & Co., a Toronto financial house ("Crang").* The District Court found that Crang "sold shares only outside the United States and only to non-Americans" (23a).

* The complaint was dismissed as against Crang for lack of *in personam* jurisdiction (49b), and review of such dismissal has not been sought by petitioner.

The third offering, also secondary, covered 3,950,000 IOS shares underwritten by an IOS subsidiary, Investors Overseas Bank, Limited ("IOB"), a Bahamian corporation. This offering was limited to IOS insiders, such as IOS officers, directors and employees, as authorized by the SEC order of May 23, 1967, and was made in Europe, Asia, Africa, Australia and South America. Like the Drexel prospectus, the IOB prospectus also stated on its face that the shares were not registered under the federal securities act and were not offered in the United States, Canada or Mexico (184A).

The prospectus for the Drexel offering was prepared outside the United States and, as the Court of Appeals noted, was "printed abroad in English, French, and German and delivered to the purchasers outside the United States" (8b). However, as stressed in the petition for certiorari, as a basis for claiming subject matter jurisdiction, discussions of a preliminary nature as to the proposed Drexel offering were held in New York, and the wording of a "sticker affixed to the cover of the prospectus" (Pet. 12), consisting of a few lines, was prepared in New York.

The prospectuses for the Crang and IOB offerings were also prepared, printed and delivered outside the United States.

Petitioner Bersch, an IOS insider, subscribed for 600 shares at $10 a share under the IOB offering, claiming, however, that before buying he "read all three prospectuses in New York" (Pet. 14).* Bersch seeks to represent a class of 100,000 purchasers under all three offerings. Since he claims that 360 class members are United States citizens (Pet. 14), the remaining 99,640 class members, or 99.6% of the putative class, are non-citizen aliens who bought stock in Europe, Africa, Asia, Australia and South America.

* Since Bersch subscribed and paid for his shares on September 3, 1969, 21 days before the date of any of the three prospectuses (47A-1), there is doubt as to the truthfulness of his statement that he read all three prospectuses before making his purchase.

The discovery in this case, consisting of depositions on oral examination and document production, did not deal with the merits, but was limited to petitioner's efforts to uncover and marshal every act of any nature performed by any defendant in the United States upon which he could base a claim under the federal securities laws to establish subject matter jurisdiction. The petition discusses at length petitioner's version of the acts which may or may not have been performed in the United States (Pet. 5-15). The Court of Appeals, which had before it all the results of petitioner's discovery, found that "none of the defendants engaged in significant activities within the United States"; that, with respect to respondent Andersen, the accounting firm, there was a "paucity of physical acts on its part in the United States"; and that the activities within the United States relied on by petitioner were "merely preparatory activities" (33b).

As shown below, the Court of Appeals' decision turned on the factual situation elicited in such discovery proceedings, on the basis of which it concluded that the federal securities laws did not apply to the non-resident aliens who bought the stock of this foreign corporation in sales made abroad because under the particular set of facts here presented their loss was not caused by any act or culpable failure to act within the United States (35b).

Reasons for Denying the Petition

(1) There is no conflict between Circuits.

The petition suggests a possible conflict between the Second Circuit decision below that the antifraud provisions of the federal securities laws do not apply to the foreign transactions here involved and the Eighth Circuit decision in *Travis* v. *Anthes Imperial Limited*, 473 F.2d 515 (8th Cir. 1973). For the petition states that in the *Travis* case "The

Eighth Circuit was 'persuaded' that Section 10b would be applicable, even if it were assumed that all the fraudulent dealings took place in Canada'' (Pet. 24). The *Travis* case, however, is not a decision ''on the same matter'' as the decision here sought to be reviewed,—the specific requirement of this Court's Rule 19.1.(b). If it were, the 77-page* petition for certiorari would have made much more than mere passing reference to the *Travis* case.

(2) The case does not present an important question of federal law which should be settled by this Court.

Also, the decision of the Court of Appeals is correct in all respects.

The petition appears to rest primarily on the provision of Rule 19.1.(b) that the Court of Appeals ''has decided an important question of federal law which has not been, but should be, settled by this court.''

The petition states that there is ''a dearth of judicial interpretation'' in this area (p. 20), but elsewhere contends that ''the law in this area is both unsettled and confused'' (p. 26). The petition further states that ''the securities statutes fail to define their extraterritorial reach'' so that there is an ''*absence of express legislative direction*''** (pp. 19-20), but elsewhere contends that the Court adopted ''a discriminatory and dangerous interpretation of those statutes, *in conflict with the language of the statutes*'' (pp. 3-4). Accordingly, the petition asks ''that this Court express its views on the issue of the extraterritorial reach of the federal securities laws'' (p. 26) and define ''the reach of the federal securities laws'', so that ''both Americans and foreigners engaged in international securities transactions'' would be put on notice ''as to what conduct and circum-

* It would suffice to deny the petition that, in consisting of 77 pages, it violates the Rule 23.4. requirement of "brevity." See, for example, *Kennemer* v. *Billington*, 323 U.S. 709 (1944).

** Italics throughout are supplied.

stances American courts will deem sufficient to warrant the exercise of jurisdiction'' (p. 28). In short, petitioner wants this Court to write a mini-treatise or handbook on the extraterritorial reach of the federal securities laws as a guide to all future foreign securities transactions, though such future transactions may take forms and involve circumstances vastly different from those at bar and which cannot now be envisaged. Obviously, this Court cannot be expected to prepare such an exposition of the extraterritorial scope and reach of the federal securities laws, especially on the basis of the limited factual situation and narrow issue here presented and decided by the Court of Appeals (as shown below, p. 8, *infra*); namely, whether or not the loss to foreigners in this particular foreign offering was directly caused by ''acts (or culpable failures to act) within the United States'' (35b).

Any ''dearth'' of judicial opinion as to whether the federal securities laws apply to foreign sales by foreign corporations of their shares to nonresident aliens of the United States exists because it has, undoubtedly, rarely occurred to anyone even to claim that the federal securities laws apply to entirely foreign transactions where no act within the United States caused the loss.

Judge Friendly's opinion, after careful analysis of the special factual situation here presented, plainly stated the law, which is neither ''unsettled'' nor ''confused'' (Pet. 26), as follows (34b-35b):

> ''We have thus concluded that the anti-fraud provisions of the federal securities laws:
>
> ''(1) Apply to losses from sales of securities to Americans resident in the United States whether or not acts (or culpable failures to act) of material importance occurred in this country; and
>
> ''(2) Apply to losses from sales of securities to Americans resident abroad if, but only if, acts (or culpable failures to act) of material importance in the

United States have significantly contributed thereto; but

"(3) Do not apply to losses from sales of securities to foreigners outside the United States unless acts (or culpable failures to act) within the United States directly caused such losses".

Such conclusion (3) as to "losses from sales of securities to foreigners outside the United States" was reached in the context of a foreign corporation which does no business in the United States, with all the prospectuses prepared, printed and delivered abroad, and with the sales consummated abroad.

Since the Court of Appeals merely directed elimination from the class of "all purchasers other than persons who were residents or citizens of the United States" (43b), allowing the case to continue in behalf of both resident and non-resident American buyers (subject to certain class action problems as to which "further factual inquiry is needed" (43b)), its holding, which the petition urges "will constitute erroneous and dangerous precedent" (p. 30), is merely as follows: The federal securities laws do not apply to sales to non-resident aliens by foreign corporations made outside the United States, where no act or culpable failure to act within the United States directly caused loss to the purchasers.

Petitioner, however, wants this Court now to prescribe a rule of law to the effect that if, for example, a French corporation, through an American underwriter acting through its French branch, sold its securities to French citizens resident in France, with the sale consummated entirely in France, on the basis of a prospectus prepared, printed and delivered in France, such French citizen is protected by the United States securities laws and may sue in the United States District Court for any loss suffered by him, if some insignificant work of a preparatory nature was performed in the United States, even though no act or culpable failure

to act, which directly caused such loss, occurred within the United States. The petition urges that the federal court must reach out and assume jurisdiction in such a case because "the United States has a peculiar responsibility of leadership" (Pet. 27).

While the petition is replete with *ipse dixit* statements of "the Congressional will" and the "legislative intent", without any reference to legislative history, it is self-evident that Congress could never have intended such a result and that such a result not only makes no sense but would be contrary to anything ever decided in any area of law as to the extraterritorial application of a United States statute. For any Court to adopt petitioner's position would, to quote petitioner, "constitute erroneous and dangerous precedent" (Pet. 30).

(3) Petitioner has misstated the position of the SEC.

Petitioner, deeming it "significant" that the Court of Appeals "did not seek advice from the SEC", states, without support in the record, that if asked the SEC would have deemed that the antifraud provisions of the securities laws "attached to the challenged transaction herein" (Pet. 37, fn.). However, the SEC is not reticent about expressing its views, as *amicus curiae*, to help achieve a desired result. Thus, in *IIT* v. *Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975), decided by the same panel of the same Court on the same day as the case at bar, the SEC submitted a brief *amicus curiae* in support of application of the federal securities laws to the situation there involved. But though the SEC was fully familiar with the case at bar, it did not submit a brief or take the position that the federal securities laws apply to the sale of IOS shares made abroad to non-resident aliens. Indeed, SEC rulings indicate the contrary.

The SEC has made it clear that registration is not required for offerings of United States corporations to foreign investors. SEC Release No. 33-4708 and No. 34-

7366, dated July 9, 1964, 17 C.F.R. §231.4708, 1 CCH Fed. Sec. Rep. ¶1362, quoted by the Court of Appeals (9b, fn. 12), state:

> "The Commission has traditionally taken the position that the registration requirements of Section 5 of the Act *are primarily intended to protect American investors.*"

Accordingly, the releases provide that the foreign nature of an offering and its exemption from registration is not affected by

> "whether the offering originates from within or outside the United States, whether domestic or foreign brokerage dealers are involved, and whether the actual mechanics of the distribution are effected within the United States, *so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States.*"

Clearly, if a foreign offering of a domestic corporation is not subject to SEC registration requirements because the Act is "primarily intended to protect American investors," *a fortiori* would the foreign offering of a foreign corporation be exempt, even though in this case, contrary to what in fact occurred, the actual mechanics of the distribution had been effected within the United States.

Petitioner argues, however, that the SEC exemption from registration does not affect liability under the antifraud provisions. Whatever application such provisions may have to foreign offerings of foreign corporations, where acts within the United States caused the loss, clearly such provisions do not apply to losses from sales of securities of foreign corporations made to foreigners outside the United States where, as the Court of Appeals here found, the loss was not caused by any act or culpable failure to act within the United States.

As already noted, the petition distorts the record when it states that the SEC considers that the antifraud provisions of the securities laws "attached to the challenged transaction herein" (Pet. 37fn.). The SEC merely takes the position that the fact that an offering may be exempt from registration because of its foreign nature does not automatically exempt it from the antifraud provisions of the securities laws, and that there may be factual situations in which an exempt offering could violate such antifraud provisions. That is vastly different from any suggestion that the SEC may have deemed such provisions to have been violated by the foreign transaction here challenged.

Had the SEC deemed that non-resident aliens who purchased IOS shares abroad had a cause of action for violation of the antifraud provisions of the federal securities laws and that the Court of Appeals' decision constituted an "erroneous and dangerous precedent", the SEC would certainly have joined in petitioner's efforts to obtain rehearing before the Court of Appeals, as the SEC has done in other situations.

(4) The Court of Appeals properly held that the proposed class is unmanageable.

Petitioner also challenges the holding below that a class consisting of over 96,600 non-resident aliens, residing in some 44 countries in Europe, Asia, Africa, Australia and South America, who bought stock of a foreign corporation outside the United States, is unmanageable,—an unmanageability which the Court of Appeals illustrated by reference to the notice and language problems, and the fact that "notice only in English" would not be justified, whereas a notice "sent in several languages" presents a problem of insuring accuracy (41b, fn. 47).

The Court of Appeals was also concerned with the fact that the uncontradicted evidence established that numerous foreign countries in Europe, Asia, Africa, Australia and South America in which the putative class members reside

would not recognize a United States judgment in favor of a defendant as a bar to an action by their own nationals, even if such persons received actual notice that they were members of the class, and would be bound by a judgment unless they opted out. The Court of Appeals noted with approval a statement in an earlier District Court opinion in this case, not included in the appendix to the petition, that "if defendants prevail against a class they are entitled to a victory no less broad than a defeat would have been" (42b),—a result impossible to achieve as to the non-resident aliens.

(5) It was proper for the Court of Appeals to decide class action issues.

Petitioner chides the Court of Appeals for considering class action issues "without receiving the views of the appellee on the issue" (Pet. 69), and claims that he was misled into believing that such issues were not before the Court, when it refused to consolidate the appeal with another appeal in which class action issues were involved and also when it refused to allow Andersen "to submit an oversize brief so as to present class action issues" (Pet. 69). A complete answer to this farfetched position is that Andersen's brief in the Court of Appeals devoted some 25 printed pages to class action issues, which petitioner refused even to consider in his brief. The Court of Appeals, in dealing with such refusal, stated (39b):

> "Regrettably plaintiff has not favored us with a response, preferring to rest on his claim, with which we disagree for reasons just developed, that the issue is not before us."

Also, it is so clear that a class of 100,000 members, over 99.6% of which are non-resident aliens, residing in 44 countries, including Europe, Africa, Asia, Australia and South America, and speaking a variety of foreign languages, is unmanageable and that such non-resident aliens can in no event be bound by a judgment, that petitioner's strategy

of disregarding these issues is based on inability to present a sound opposing position, and not on sincere conviction that class action issues were not before the Court of Appeals, and that it was estopped from considering such issues when presented by Andersen.

(6) Petitioner's personal attack on Judge Friendly is scandalous.

Finally, petitioner seeks certiorari on the ground that Judge Friendly, who wrote the Court's opinion and, presumably, unfairly influenced his two brethren on the panel, has "an antipathy toward class actions" (Pet. 29), and that his opinion is based "primarily upon the prejudices of its author with respect to class actions" (Pet. 30). The petition irrelevantly argues that Judge Friendly "considers the settlement of class actions 'blackmail' ", citing his book on *Federal Jurisdiction: A General View,* 120 (1973) (Pet. 68). The scandalous matter in this petition should suffice to warrant its being stricken by the Court (Rule 40).

However, to illustrate the type of distortion which permeates the petition, it may be noted that Judge Friendly's book on Federal Jurisdiction merely referred to a particular and, unfortunately, all too common, type of situation, which he described as follows:

> "While the benefits to the individual class members are usually minuscule, the possible consequences of a judgment to the defendant are so horrendous that these actions are almost always settled. Generally, this is for a figure constituting a small fraction of the amount claimed but large enough to yield compensation to the plaintiffs' lawyers which seems inordinate even in these days of high legal fees" (at pp. 119-120).

Despite the self-righteousness of petitioner's attorney, his conduct in this case exemplifies Judge Friendly's statement.

The claim in this case is for $110,000,000 plus interest, attorneys' fees and disbursements. According to the complaint and the petition, the principal wrongdoers are the six underwriters, particularly Drexel and Smith Barney, whose "participation", petitioner asserts, "was essential to the success of the IOS Public Offering", and who "lent their prestige and capital to the offering and augmented its American image" (Pet. 7). Yet, petitioner's counsel has entered into a proposed settlement agreement with these six underwriters to settle the $110,000,000 claim against them for only $700,000 (13b-14b).

On the other hand, for a case in which there was no discovery on the merits and which was in a very preliminary stage, under the proposed $700,000 settlement petitioner's counsel would receive a $200,000 fee and $10,000 reimbursement of expenses (14b). The settling defendants,—the underwriters with the primary responsibility in this matter, who realized the major profit on the underwriting,—would thus pay substantially less than the anticipated cost of defending the action.

The proposed settlement is approximately one half of one percent of the claim. With 100,000 class members and 11,000,000 shares sold, the average recovery for each class member would be less than $5.00, and the average recovery per share would be less than five cents. Accordingly, what petitioner is here seeking to accomplish is the clearest evidence in support of Judge Friendly's above-quoted statement as to class actions, for which he is so roundly chided by petitioner's counsel.*

* The personal attack on Judge Friendly in the petition, unseemly as it is, is substantially more restrained than in the petition for *in banc* rehearing in the Court of Appeals, dated May 9, 1975. That petition for rehearing, which was primarily a personal attack on Judge Friendly, states that the Court of Appeals' decision represents "the personal predilections of Judge Friendly and his bias toward class actions" (p. 3); "is characterized by a parochial outlook" (p. 4); that Judge Friendly is "insensitive to the rights of individuals," and that his opinion is premised "on the prejudices of its author with respect to class actions" (p. 4); that "Judge Friendly's free-wheeling interpretation of Congressional 'intent' constitutes only an expression of his own views" (p. 6), as though his two distinguished colleagues who concurred in the decision had no independent views and were Judge Friendly's puppets; that Judge Friendly substituted for the language of the statute "his own judicial creation of artificial categories" for the statutory language (p. 8); that Judge Friendly was seeking "to achieve the scheme of society which he entertains" (p. 20); that he had "an ulterior motive, perhaps sub-conscious" (p. 21); that his opinion was based on "bias" (p. 22); that his motive is to "turn the clock back to the days before class actions" (pp. 24-25); and that "admittedly",—without pointing to any place where this admission was made,—Judge Friendly's opinion does not represent "the view of Congress, but the opinion of a judge who is no longer an active member of this court" (p. 25), suggesting possible superannuation. Finally, the petition concludes with repetition of the charge that the opinion is based upon "personal prejudices" (p. 25). Petitioner's counsel's disappointment over loss of his $200,000 fee can hardly justify his unrestrained attack on one of the most distinguished jurists of this country.

Conclusion

The petition states nothing which warrants review by this Court, on the basis of the considerations governing review on certiorari set forth in Rule 19 or otherwise, and there are no special or important reasons for granting the writ. Also, the decision of the Court of Appeals is correct in all respects. Accordingly, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-596

HOWARD BERSCH,

Petitioner,

v.

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION FOR I.O.S., LTD. (Now in Liquidation)

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BRIEF IN OPPOSITION FOR I.O.S., LTD.
(Now in Liquidation)

Respondent I.O.S., Ltd. ("IOS"), as now in liquidation pursuant to the Winding-Up Act of Canada, Revised Statutes of Canada, ch. W-10 (1970), prays that this Court deny the Petition for Certiorari herein (the "Petition") for the reasons hereinafter set forth.

Opinions Below

The opinions below, which are attached as Appendices "A" and "B" to the Petition, are officially reported at 519 F.2d 974 (2d Cir. 1975) and 389 F. Supp. 446 (S.D.N.Y. 1974).•

Question Presented for Review

IOS hereby adopts and incorporates by reference as its statement of the Question Presented for Review herein the first "Question Presented" as set forth in the Brief for Arthur Andersen & Co. in Opposition to the Petition (the "Andersen Brief"), at pages 1-2 thereof. It is IOS' position herein that the second "Question Presented" in the Andersen Brief is a subsidiary question fairly comprised in the first Question Presented and need not be stated separately.

Statement of the Case

The basic facts and legal arguments underlying IOS' opposition to the Petition herein are set forth cogently and in considerable detail in the Andersen Brief. Accordingly, IOS will not burden the Court with a repetition of such facts and arguments and they are incorporated by refer-

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• References herein to these opinions will be to the relevant pages of the Federal Reporter or Federal Supplement.

ence herein. IOS will, however, hereinafter set forth certain supplementary facts and arguments and will briefly summarize others which in its view deserve emphasis in opposition to the Petition.

IOS' Liquidation

At the outset, it should be noted that IOS, the company whose common shares were sold in the three stock offerings which are the subject of this action, is now in liquidation proceedings before the courts of New Brunswick, Canada (IOS' corporate domicile) pursuant to the Winding-Up-Act of Canada, Revised Statutes of Canada, 1970, ch. W-10 as amended.

IOS' liquidation proceedings were commenced in August 1973 as a direct result of understandings reached earlier that summer by an international governmental committee (which included representatives of the United States Securities and Exchange Commission) to the effect that—in the aftermath of the now-notorious "Vesco era" in IOS' history—the numerous IOS entities should be wound-up or liquidated in their respective corporate domiciles.* See 519 F.2d at 978 n.4.

IOS has made only a limited and special appearance herein, through its court appointed Co-Liquidators. Said appearance was made solely in an effort to protect the estate of IOS for the benefit of all its worldwide creditors and shareholders, by preventing the decentralized determination of claims against IOS in forums other than the Canadian liquidation court.**

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* The transactions involved in the present action occurred long prior, and are unrelated, to the "Vesco era" which led to IOS' ultimate downfall.

** For these reasons, IOS, as an alternative to its motion to dismiss for lack of subject matter jurisdiction, also moved in the

(*footnote continued on following page*)

Relevant Facts

With respect to the issues raised by the present Petition, the following facts should be emphasized:

—IOS was at the time of the 1969 offerings and at all times thereafter incorporated under the laws of Canada,* with active business offices in Geneva, Switzerland and other locations, all outside the United States. IOS conducted no business in the United States.**

—At no time was IOS stock listed on any United States stock exchange or traded in the securities markets of this country. In fact, in May 1967, IOS had consented to an SEC order which prohibited IOS from engaging in any activity subject to the jurisdiction of the SEC and from making any sales of securities to United States citizens or nationals, except for sales outside the United States to "officers, directors and full time personnel of IOS and its subsidiaries." In connection with the 1969 offerings which are the sub-

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(*footnote continued from preceding page*)

District Court for a stay of proceedings as against it in favor of the Canadian liquidation court. While this stay motion was summarily denied by the District Court, 389 F. Supp. at 463, the Court of Appeals, relying on this Court's decisions in *Canada Southern Ry. Co.* v. *Gebhard*, 109 U.S. 527 (1883) and *Pennsylvania* v. *Williams*, 294 U.S. 176 (1935), granted IOS leave to renew the motion if IOS is not satisfied to proceed with the litigation on the more limited basis resulting from the Court of Appeals' decision. 519 F.2d at 1001. IOS intends to renew its stay motion if the litigation is pursued by petitioner after the Petition is decided.

* Its predecessor company was a Panamanian corporation.

** Although petitioner makes much ado about the American nationality of some of the other participants in the underwritings, the fact is that the "American" companies involved were actually international organizations whose work in connection with the offerings was conducted primarily by or through European offices.

ject of the instant action, IOS was in compliance with the aforesaid order, and at no time since has the SEC taken the position—despite investigation by it—that any part of said offerings violated the 1967 order.

The latter point is not surprising in view of the additional facts that:

—In two of the three offerings involved here, in which more than 7,000,000 shares were sold (*i.e.*, the so-called Drexel and Crang Offerings), *all* of the purchasers were citizens and residents of foreign countries, and not a single share was offered or sold to a citizen or resident of the United States. With respect to the Crang offering it is noteworthy that the prospectus was reviewed and cleared in its initial and final forms by the ten provincial securities commissions of Canada;

—In the third offering, in which 3,950,000 shares were sold (*i.e.*, the IOB Offering), sales were made only to IOS insiders, and all but a small number of such purchasers were citizens and residents of foreign countries;*

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* Actually, only a trivial number—somewhere between 11 and 37—of the purchasers were *resident* Americans; and only some 360 *non-resident* Americans also bought in the IOB offering. Significantly, of the resident American purchasers, at least four of them were also sellers in the IOB Offering. Moreover, of a total of 51,548 IOS shares purchased by resident Americans (out of 11,000,000 in the three offerings), the purchasers of approximately 34,400 such shares were *directors* of IOS—*i.e.*, in substance defendants in this action.

Petitioner Bersch was at the time of his purchase of 600 shares an officer of an IOS-related company which was run by a member of the IOS Board of Directors. For three years prior to his purchase petitioner had been employed by a different IOS-related company. The Court below has raised substantial questions as to whether petitioner or any other similarly situated IOS insider could be considered a proper representative of the class, 519 F.2d at 997-98.

—All sales in all three offerings were consummated in foreign countries;

—The three prospectuses pursuant to which the offerings were made were prepared in foreign countries;

—The only conduct which occurred in the United States in connection with any of the offerings consisted of several preliminary meetings and discussions among representatives of the Drexel Group, Arthur Andersen & Co. and IOS, all of which occurred long before the offerings were made, and none of which involved the formulation of any fraudulent scheme or any contact with the persons who later purchased in any of the offerings. Indeed, the record discloses that the few contacts with the United States related solely to (a) the initial decision of some of the underwriters to participate in one of the offerings (which was itself to be conducted overseas) and (b) several attempts to assure (not avoid) full disclosure in the prospectuses.*

Proceedings Below

In the District Court, all of the defendants herein moved to dismiss the complaint for lack of subject matter jurisdiction, either in its entirety or as to the thousands of non-resident foreign purchasers in the three offerings whom petitioner purported to represent. These motions were denied by the District Court which, however, noted that

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* Interestingly, petitioner has never cited to any United States contact which in any way could be construed as fraudulent or otherwise wrongful. Rather he is reduced to relying on such trivial and insignificant occurrences in the United States as the fact that a certain "sticker", which was affixed to the prospectuses, was drafted in New York (P. 12). Yet the fact is that the "sticker" was designed only to report an SEC investigation of IOS which had been instituted shortly before the prospectuses were distributed. Clearly the addition of the sticker was part of an effort to make full disclosure about IOS—not to conceal or misstate facts.

there was a substantial basis for disagreement with its holding in favor of jurisdiction, and therefore certified the question for immediate appeal pursuant to 28 U.S.C. § 1292(b).

The Court of Appeals reversed the determination that there was subject matter jurisdiction over the claims asserted on behalf of the foreign purchasers. In a lengthy and thoughtful opinion for a unanimous Court, Judge Friendly held that while the domestic conduct of the defendants, even though not fraudulent, might be sufficient to warrant the exercise of jurisdiction over the claims of American purchasers, neither that conduct nor the alleged domestic "effects" of the three offerings could suffice as a basis of jurisdiction over the claims of the thousands of unnamed non-resident foreign purchasers who formed the vast majority of petitioner's class.

Argument

Review by this Court of the Court of Appeals' decision is not warranted. Contrary to petitioner's assertions, the decision of the Court below does *not* raise "important issues with respect to the extraterritorial reach of the federal securities laws" (P. 28-29), but is merely a rebuff—based on a careful study of the facts of this case—of petitioner's attempt to apply the securities laws of the United States to claims asserted on behalf of thousands of unnamed foreign class members based on transactions lacking any significant relationship to the United States.

Unfortunately, petitioner has totally ignored the thrust of the opinion below. The Court of Appeals held that, regardless of the nationality of some of the defendants, foreign nationals residing in foreign countries who purchased securities of a foreign issuer in a foreign country cannot claim a right to sue in a United States court unless the defendants' conduct in the United States was some-

how culpable, wrongful or fraudulent or was otherwise a significant cause of the loss alleged to have been suffered by the foreign purchasers. The Court of Appeals was convinced from the record before it that no such conduct occurred here. That factual determination was crucial to its decision. As such the decision is fully consistent with well-settled principles limiting the extraterritorial reach of American law and thus, under the criteria of Rule 19.1(b) of the Rules of this Court, does not merit consideration here.

I

The Decision Below is Fully Consistent with All Relevant Prior Decisions and with the Statutory Purpose of Section 10(b) of the Securities Exchange Act of 1934

The Court of Appeals' determination that Section 10(b) does not confer federal jurisdiction over securities fraud claims on behalf of foreign purchasers of foreign securities who cannot show that there has been any fraud prepared or practiced in this country is consistent with every relevant prior case. The numerous federal courts which have considered the issue of jurisdiction over foreign transactions involving no domestic fraud have without exception construed Section 10(b) as *not* reaching such extraterritorial transactions. See, *e.g.*, *SEC* v. *Kasser*, 391 F. Supp. 1167, 1176-77 (D.N.J. 1975); *Investment Properties International, Ltd.* v. *I.O.S., Ltd.* [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011, at 90,736-37 (S.D.N.Y.), *aff'd without opinion* (unreported 2d Cir. 1971); *Finch* v. *Marathon Securities Corp.*, 316 F. Supp. 1345, 1349 (S.D.N.Y. 1970); see also *Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515, 526 (8th Cir. 1973); *SEC* v. *United Financial Group*, 474 F.2d 354, 356 (9th Cir. 1973); *Leasco Data Processing Corp.* v. *Maxwell*, 468 F.2d 1326, 1337 (2d Cir. 1968); *Madonick* v. *Denison Mines Ltd.* [1973-

74 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,550, at 95,909 (S.D.N.Y. 1974); *Garner* v. *Pearson*, 374 F. Supp. 591, 599 (M.D. Fla. 1974); *Sinva* v. *Merrill Lynch, Pierce, Fenner & Smith*, 48 F.R.D. 385, 386 (S.D.N.Y. 1969); *SEC* v. *Gulf International Finance Corp.*, 223 F. Supp. 987, 994 (S.D. Fla. 1963). The decision below has thus far been followed in the one extraterritorial case reported since the decision was handed down. *F.O.F. Proprietary Funds, Ltd.* v. *Arthur Young & Co.* [Current] CCH Fed. Sec. L. Rep. ¶ 95,286 (S.D.N.Y. 1975).

Petitioner's attempt (P. 24-25) to imply that there is some conflict among the Circuits by reason of the Eighth Circuit's decision in *Travis, supra,* is unavailing. Indeed *Travis,* like each of the other cases cited above, required some evidence of fraudulent conduct in the United States as a pre-condition to finding jurisdiction over an otherwise extraterritorial transaction. Thus, in *Travis* the Court stated: "Here, as in *Leasco,* the scales are tipped in favor of applicability *because misrepresentations were made in the United States.*" 473 F.2d at 526 (emphasis added).*

Moreover the decision of the Court below that jurisdiction does not attach "where the United States activities are merely preparatory or take the form of culpable nonfeasance and are relatively small in comparison to those abroad," 519 F.2d at 987, is entirely consistent with the statutory purpose of Section 10(b). Section 10(b) is an *antifraud statute:* Congress cannot have intended that section to apply to transactions, all indicia of which are otherwise wholly foreign in nature, when it cannot be

* Moreover, the dictum in *Travis* to which petitioner makes reference in the Petition (P. 24-25) cannot under any view be deemed authority for allowing suit by *foreign* purchasers of foreign securities since the plaintiffs in *Travis* were solely *American* shareholders; indeed, the American plaintiffs there had obtained the Canadian securities in suit as consideration for their sale of their controlling interests in an American company to the Canadian defendants.

shown that any fraudulent conduct occurred in the United States—when all that happened here was preliminary and ancillary to the substantial work on the transaction, all performed and consummated overseas. See 519 F.2d at 985 n.24.

It is also indisputable that the fundamental purpose of the American securities laws is the protection of American investors. Accordingly, extraterritorial application of those laws is not justified unless such application would protect American investors. See, *e.g., Leasco Data Processing Corp.* v. *Maxwell, supra,* 468 F.2d at 1336-37; *Schoenbaum* v. *Firstbrook,* 405 F.2d 200, 206, *rev'd in part on other grounds,* 405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied sub nom. Manley* v. *Schoenbaum,* 395 U.S. 906 (1969); *S.E.C.* v. *Kasser, supra,* 391 F. Supp. at 1175. Here the Court of Appeals has *permitted* all *American* purchasers to sue. The statutory purpose thus is not advanced one iota by also permitting suit by tens of thousands of foreign purchasers.*

Finally, the Court of Appeals was obviously correct in rejecting petitioner's argument that jurisdiction should be assumed because of the alleged domestic "effects" on American securities markets of the 1969 offerings. 519 F.2d at 987-990. Certainly Congress could not have intended the federal courts to take jurisdiction over wholly foreign transactions based merely on highly generalized,

* Of course, as specifically noted by the Court of Appeals, "Congress did not mean the United States to be used as a base for fraudulent securities schemes even when the victims are foreigners, at least in the context of suits by the SEC or by named foreign plaintiffs," 519 F.2d at 987, and that Court upheld jurisdiction where the United States had been used as a base for such a scheme in *IIT* v. *Vencap, Ltd.,* 519 F.2d 1001 (2d Cir. 1975), decided the same day as this case. But the distinction drawn by the Court between the fraudulent domestic conduct found in *Vencap* and the wholly preliminary, non-fraudulent conduct found in the present case is fundamental and obviously consistent with the basic purposes of the antifraud statute.

speculative and self-serving claims that foreign investor confidence and trust in the American market was impaired. Yet such self-serving claims are all that petitioner has offered in support of his "effects" argument.

The whole of petitioner's proof of these "effects" was a brief affidavit by one Associate Professor Morris Mendelson, prepared at petitioner's instance. Indeed, as a close reading of that document discloses, even Professor Mendelson recognizes that the alleged loss of investor confidence which his affidavit describes stemmed not from the 1969 offerings but rather from IOS's financial collapse—which did not even begin until perhaps April of 1970, more than six months *after* the 1969 offerings were consummated. Any effects traceable to those events—or to the events following thereafter, when IOS fell into the hands of Robert L. Vesco and his associates—are completely irrelevant to the issue of jurisdiction over the 1969 offerings. Indeed even the District Court—which upheld jurisdiction over the foreign purchasers' claims—stated with respect to petitioner's "effects" argument that, notwithstanding the Mendelson affidavit, "the impact on the American securities market of the I.O.S. offering [*sic*] was in fact less than direct." 389 F. Supp. at 461. This conclusion is substantiated by a major SEC report to Congress in 1971 which concluded that the sales by IOS-related mutual funds had no "significant direct effect on general market stability". *Institutional Investor Study Report,* H.R. Doc. No. 64, 92nd Cong., 1st Sess., vol. 3, p. 947 (1971).

In this connection it is further highly noteworthy that the SEC, which is charged by the Exchange Act with protecting the integrity of the United States securities markets, has not supported petitioner's position herein by deed or word. Indeed, contrary to petitioner's elaborate argument that the SEC's posture in matters of the kind involved here would be in favor of jurisdiction in United States courts, the facts are that (a) the Commission never took any action against the participants in the 1969 offer-

ings based on any aspect of their participation therein—notwithstanding that IOS furnished complete information about the offerings to the Commission, *cf.* 519 F.2d at 991; (b) prior to IOS' liquidation the SEC *had* instituted a major court proceeding based on later events during the "Vesco era" in IOS' history* and said nothing about the 1969 offerings; and (c) the SEC did not even file a brief *amicus curiae* in support of petitioner's position below, notwithstanding that it did so in *IIT* v. *Vencap, Ltd., supra,* which involved the issue of jurisdiction over extraterritorial transactions where fraud *had* been practised in this country. See p. 9, n.*, *supra.***

II

Compelling Reasons of Policy Also Support the Decision Below

Compelling reasons of policy—all of them illustrated by the facts of this very case—also support the decision below declining jurisdiction over the foreign purchasers' claims.

Thus this Court and the lower federal courts have long recognized that unwarranted intrusion into foreign transactions by the courts of the United States creates the risk of conflict with the legal systems of friendly sister nations and therefore should be avoided. See, *e.g., Scherk*

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* *S.E.C.* v. *Vesco,* 72 Civ. 5001 (S.D.N.Y.) (C.E.S.).

** Moreover, it is significant that the SEC has expressly exempted foreign offerings from the registration requirements of the Securities Act—even when the issuer, unlike IOS, is an American company. This exemption is available without regard to "whether the offering originates from within or outside of the United States, whether domestic or foreign broker-dealers are involved and whether the actual mechanics of the distribution are effected within the United States, so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States." S.E.C. Release No. 33-4708 and No. 34-7366, 17 C.F.R. § 231.4708, 1 CCH Fed. Sec. L. Rep. ¶ 1362 (1964). There can be no question that the 1969 offerings—even if they had been made by an *American* issuer—would have satisfied these guidelines.

v. *Alberto-Culver Co.*, 417 U.S. 506, 517 & n.11 (1974); *Foley Bros.* v. *Filardo*, 336 U.S. 281, 285 (1949); *Investment Properties International, Ltd.* v. *I.O.S., Ltd., supra* [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011, at 90,735.

In this case, the prospect of such conflict is a near-certainty if the decision of the Court of Appeals is reversed. Thus, undisputed affidavits of foreign law submitted below establish that the courts of England, the Federal Republic of Germany, Switzerland, Italy and France would not recognize a judgment in this case in favor of the defendants as a bar to an action by their own citizens in their own countries. 519 F.2d at 996-97. Moreover, hundreds of claims by purchasers in the 1969 offerings—all members of petitioner's alleged class—have already been asserted, and some of them adjudicated, in Swiss proceedings against respondent Bernard Cornfeld.

With reference to IOS in particular, by virtue of its ongoing liquidation in the Canadian courts, there is obviously a strong interest in assuring that claims against the estate are asserted in those centralized proceedings. See *Canada Southern Ry. Co.* v. *Gebhard, supra; Pennsylvania* v. *Williams, supra.* At the very least, difficult questions of recognition of foreign judgments will arise in those proceedings if this action goes forward against IOS in the courts of the United States.

Moreover considerations of sound judicial administration strongly support the Court of Appeals' decision. As stated by that Court:

> When as here, a court is confronted with transactions that on any view are predominantly foreign, it must seek to determine whether Congress would have wished the precious resources of United States courts and law enforcement agencies to be devoted to them rather than leave the problem to foreign countries.
>
> —519 F.2d at 985.

Here it is crystal clear that adjudication of the foreign purchasers' claims in the federal courts would be extraordinarily difficult, if not impossible. The management of a class action where virtually the entire class resides in foreign countries all over the world would impose enormous burdens on already overtaxed district courts, and it is hard to see how compliance with the various protections embodied in Rule 23 of the Federal Rules of Civil Procedure could be assured. Compare 519 F.2d at 996 & n.47; *cf. id.* at 997 n.48. Furthermore, as noted above, there are very serious doubts whether any adjudication in our courts would be given effect by foreign courts.

For these reasons of comity and sound judicial administration as well, the Court of Appeals was correct in holding that the claims asserted on behalf of the foreign purchasers should be dismissed.

CONCLUSION

The Petition for Certiorari should be denied.

December 3, 1975.

Respectfully submitted,

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